

UniSource Energy
E-04230A-03-0933

6/21/2004
Volume I



1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

BEFORE THE ARIZONA CORPORATION

IN THE MATTER OF THE) DOCKET NO.
REORGANIZATION OF UNISOURCE) E-04230A-03-0933
ENERGY CORPORATION.)
)

At: Tucson, Arizona

Date: June 21, 2004

Filed: June 22, 2004

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME I
(Pages 1 through 200)

ARIZONA REPORTING SERVICE, INC.
Court Reporting
Suite Three
2627 North Third Street
Phoenix, Arizona 85004-1126

BY: DAWNA J. BOSWELL, RPR
Certified Court Reporter
Certificate No. 50326

Prepared for: ANNETTE SATTERLEE, RPR
Certified Court Reporter
Certificate No. 50179

ACC

ORIGINAL

[illegible]

1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Room 222 of said
4 Commission, 400 West Congress, Tucson, Arizona,
5 commencing at 10:13 a.m., on the 21st day of June, 2004.

6
7 BEFORE: WILLIAM A. MUNDELL, Commissioner
8 MIKE GLEASON, Commissioner
9 KRISTIN K. MAYES, Commissioner

10 JANE L. RODDA, Administrative Law Judge

11 APPEARANCES:

12
13 For Applicant UniSource Energy Corporation:

14 ROSHKA HEYMAN & DeWULF, PLC
15 By Mr. Raymond S. Heyman
16 One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

17 For Arizona Corporation Commission Staff:

18 Mr. Christopher Kempley, Chief Counsel
19 and Ms. Lisa Vandenberg
Legal Division
20 1200 West Washington
Phoenix, Arizona 85007

21
22 For Intervenor Residential Utility Consumer Office:

23 Mr. Daniel Pozefsky
24 1110 West Washington, Suite 220
Phoenix, Arizona 85007

25

1 APPEARANCES: (Continued)

2

For Intervenors IBEW Locals 387 and 769:

3

LUBIN & ENOCH, P.C.

4

By Mr. Nicholas J. Enoch

349 North Fourth Avenue

5

Phoenix, Arizona 85003

6

For Intervenor Lawrence V. Robertson, Jr.:

7

Mr. Lawrence V. Robertson, Jr., In Propria Persona

8

333 North Wilmot, Suite 300

Tucson, Arizona 85711

9

10 For Intervenor Marshall Magruder:

11

Mr. Marshall Magruder, In Propria Persona

Box 1267

12

Tubac, Arizona 85646

13

For Intervenor Arizona Utility Investors Association:

14

Mr. Walter W. Meek, President

15

2100 North Central Avenue, Suite 210

Phoenix, Arizona 85004

16

17 For Intervenor Mohave County: (Appearing
Telephonically)

18

Mohave County Attorney's Office

19

By Mr. John White

Post Office Box 7000

20

Kingman, Arizona 86402

21

22

23

24

25

1 APPEARANCES: (Continued)

2

3 For Intervenor Punto de Vista Property Owners
4 Association: (Appearing Telephonically)

5

6 Mr. Marc Goldstone, Director
7 4090 Yucca Road
8 Bullhead City, Arizona 86429

9

10

11

12

DAWNA J. BOSWELL, RPR
Certified Court Reporter
Certificate No. 50326

13

14

ANNETTE SATTERLEE, RPR
Certified Court Reporter
Certificate No. 50179

15

16

17

18

19

20

21

22

23

24

25

1 ALJ RODDA: We're going to get started and
2 go on the record now.

3 So this is the time set for the hearing in
4 Docket Number E-04230A-03-0933 In the Matter of the
5 Reorganization of UniSource Energy Corporation.

6 Good morning, everyone, and welcome to the
7 Arizona Corporation Commission. My name is Jane Rodda,
8 and I'm the administrative law judge who will be
9 presiding over the evidentiary hearing and will be
10 preparing a Recommended Opinion and Order for the
11 disposition of the Commission.

12 First thing I would like to do this morning
13 is to introduce the Commissioners who are here with me.
14 We have Commissioner Mayes over here to my right and
15 Commissioner Gleason.

16 We will take appearances of the parties.

17 You know what I forgot to do? The other
18 intervenors.

19 Good morning. Hello, this is Jane Rodda.

20 MR. GOLDSTONE: Hi, Your Honor. This is
21 Marc Goldstone with the Punto de Vista Property Owners
22 Association.

23 ALJ RODDA: Okay. Is there anyone else on
24 the phone? I'm sorry?

25 MR. GOLDSTONE: Not that I know of.

1 ALJ RODDA: Not yet, okay.

2 I will note for the record that our
3 proceeding today is being Webcasted, and although all of
4 you are in the room, if you weren't in the room, you
5 could access the proceedings today at the Commission
6 website at www.acc.az.us, and then there is a link for
7 the UniSource Webstreaming. In case you are wondering,
8 there are several intervenors who live in Mohave County,
9 and we are allowing them to participate via telephone.
10 And I know that they will be, from my conversations with
11 them, I think they'll be listening to most of the
12 proceeding on the Webcast, but they will have the
13 opportunity to ask, participate as intervenors through
14 our phone line that we've made available.

15 All right, so I'm going to take appearances
16 of the parties. So on behalf of UniSource.

17 MR. HEYMAN: I bring my own music with me.

18 ALJ RODDA: Yes, that's nice.

19 MR. HEYMAN: Good morning, Commissioner
20 Gleason, Commissioner Mayes and Judge Rodda, Ray Heyman
21 from the law firm of Roshka Heyman & DeWulf on behalf of
22 the applicant, UniSource Energy Corporation.

23 ALJ RODDA: Welcome to Tucson.

24 Now I am going to start with the
25 intervenors, and I will just start with those in the

1 room with me.

2 On behalf of RUCO.

3 MR. POZEFSKY: Good morning, Your Honor,
4 good morning, Commissioner Mayes, Commissioner Gleason,
5 Daniel Pozefsky on behalf of RUCO.

6 ALJ RODDA: Thank you.

7 And on behalf of the Arizona Utility
8 Investors Association.

9 MR. MEEK: Thank you, Your Honor. Good
10 morning, Commissioner Mayes, Commissioner Gleason,
11 Walter Meek for the Arizona Utility Investors
12 Association as President.

13 ALJ RODDA: Great. Welcome back to Tucson.
14 And on behalf of Mr. Magruder.

15 MR. MAGRUDER: Mr. Magruder representing
16 himself.

17 ALJ RODDA: And on behalf of IBEW Locals 387
18 and 769.

19 MR. ENOCH: Good morning, Your Honor,
20 Nicholas Enoch of Lubin & Enoch on behalf of Locals 387
21 and 769 of the International Brotherhood of Electrical
22 Workers.

23 ALJ RODDA: Great. Welcome to Tucson.
24 Is Mr. Robertson here?

25 MR. ROBERTSON: Good morning, Judge Rodda,

1 Commissioners Mayes and Gleason, Lawrence V. Robertson,
2 Jr. on behalf of myself.

3 ALJ RODDA: Now I am going to, let's see, on
4 the phone we have the Punto de Vista Property Owners
5 Association.

6 MR. GOLDSTONE: Yes, this is Marc Goldstone
7 representing the Punto de Vista Property Owners
8 Association. Good morning, Your Honor, and
9 Commissioners.

10 ALJ RODDA: Good morning to Tucson, at least
11 your voice.

12 MR. GOLDSTONE: At least virtually.

13 ALJ RODDA: And is there anyone on the phone
14 from Mohave Valley Elementary School District, or Mohave
15 County?

16 MR. WHITE: Mohave County, Your Honor, John
17 White representing Mohave County.

18 ALJ RODDA: Welcome to Tucson, too,
19 Mr. White.

20 Could I ask you, have you been, did you hear
21 the first part of the proceeding on the Webcast?

22 MR. WHITE: Yes, ma'am, I did, and it's very
23 clear.

24 ALJ RODDA: Excellent. You're my test then.

25 All right. The first thing we are going to

1 do this morning is any additional public comment.

2 MR. KEMPLEY: Your Honor, one last
3 appearance.

4 ALJ RODDA: Oh, I'm sorry.

5 COM. GLEASON: You're not important.

6 ALJ RODDA: Oh, well, never mind him. I'm
7 sorry, on behalf of Commission Staff.

8 MR. KEMPLEY: Thank you, Your Honor, good
9 morning. Good morning, Commissioner Gleason,
10 Commissioner Mayes.

11 It's one of the privileges that Staff has to
12 normally be last in these proceedings, and it's not
13 surprising in the numbers that we've got that sometimes
14 you might miss us. On behalf of Commission Staff
15 appearing is Christopher Kempley, and with me is Lisa
16 Vandenberg of Legal Division of the Corporation
17 Commission.

18 ALJ RODDA: Great. Thank you, Mr. Kempley.
19 Sorry. Welcome to Tucson. I was so excited about this
20 Webcasting and whether they could hear us that I
21 overlooked you.

22 All right, so I'm going to ask, I have the
23 speaker slips for those who have indicated a desire to
24 make public comment this morning, and I'm just going to
25 go through them. If you would come up to the podium

1 when I call your name and state your name and spell it
2 for the court reporter.

3 So the first slip I have this morning is
4 from Mr. Walkup, the mayor of Tucson.

5 (Commissioner Mundell enters the hearing.)

6 MAYOR WALKUP: Good morning. That's
7 W-a-l-k-u-p. Commissioner Mayes, Commissioner Gleason,
8 my very great pleasure to be here.

9 What I would like to do is read a bit of
10 testimony, and then be available for any questions that
11 you might have after I'm done. But members of the
12 Arizona Corporation Commission, I am here today to speak
13 in favor of the proposed UniSource acquisition.

14 Bottom line is that this acquisition will
15 make Tucson Electric Power stronger and more able to
16 serve the Tucson community. The acquisition will
17 improve TEP's financial condition. This will allow TEP
18 to invest in more infrastructure for our growing
19 community. It will also allow TEP and UniSource to
20 continue to contribute to programs within the community
21 by participating in volunteer community activities at a
22 higher rate than they have done before.

23 I have spoken personally to the UniSource
24 executives, and I am confident that the acquisition will
25 benefit both the company and the community. The ACC

1 will continue to oversee TEP's rates to the public.
2 That will not change with this acquisition. The current
3 Tucson management team will stay in place. That will
4 not change either. In particular, the retention of Jim
5 Pignatelli as CEO will allow him to continue his
6 community leadership on issues such as economic
7 development and health care. Local management will mean
8 the same degree of local control of TEP that exists
9 today.

10 UniSource has done a terrific job of turning
11 the company around in the past ten years. This is why
12 UniSource is now a company that investors want to own.
13 We should applaud the fact that new capital is
14 interested in Tucson and southern Arizona as a growth
15 area. It bodes well for future investment in our
16 community on a larger scale. So thank you very much,
17 members of the Commission, for your consideration and
18 the work on behalf of the State of Arizona.

19 I'm available to answer any questions
20 anybody might have.

21 ALJ RODDA: Commissioner Gleason.

22 COM. GLEASON: Yes, welcome, Mayor. Glad
23 you could be here.

24 I wanted -- one of the important points I
25 think that you brought up that it is important to keep

1 the local management the same management team that we
2 have, both from your aspect as a community, it's
3 important to keep those people for your community. Is
4 that --

5 MAYOR WALKUP: And I have had a lot of
6 experience over the last ten years, but certainly as
7 Mayor with the issue of acquisitions, Ratheon, for
8 example, acquisition of Texas Instruments and
9 Burr-Brown. We are involved with investments in our
10 downtown Rio Nuevo, but certainly the investment of
11 UniSource and TEP, and that has provided an
12 extraordinary benefit to the community.

13 The team that has been in place with TEP has
14 been in place over these past many years and I can just
15 tell you that it's extraordinarily beneficial to the
16 City of Tucson and to the leadership of Tucson that that
17 team has been placed. We work very, very well on issues
18 with the community, so I can tell you almost
19 categorically that it has been a very great partnership
20 we have experienced over the past many years, and
21 certainly over the past five years as Mayor of Tucson.

22 ALJ RODDA: Thank you.

23 Commissioner Mayes.

24 COM. MAYES: Mayor, thanks for coming. I
25 appreciate you being here and offering your input. As

1 you know, your opinion carries a lot of weight with me
2 and I'm sure the other Commissioners.

3 A couple questions: When you were having
4 your discussions with UniSource and with Jim Pignatelli,
5 what kinds of questions did you ask him? And second, I
6 hear what you're saying about the fact that you are
7 assured that Mr. Pignatelli and the top management will
8 stay for I guess it's about five years that they've
9 assured us, but what assurances do we have beyond five
10 years, and are you concerned about that? I mean, what
11 happens when Mayor Walkup isn't around anymore and Jim
12 Pignatelli isn't around? At least -- God forbid that
13 happen too soon, but at some point down the road,
14 someone else will be in leadership, and --

15 MAYOR WALKUP: Yes, let me just answer that.
16 I asked those very questions, and I've known Jim almost
17 from the first day he arrived here many, many years ago
18 under TEP management. So I've watched his development
19 as the CEO of TEP and with the acquisition of UniSource,
20 and I'm not concerned with this investment. Frankly, if
21 I were in New York City or some other place than Tucson
22 I would consider this a very reasonable acquisition and
23 investment to be able to make. But I asked the
24 question, I said, "Jim, how long can we count on you in
25 your leadership position," and he said that it was five

1 years.

2 But let me tell you, my experience with
3 quality leadership within companies, one of the things
4 they are very concerned about is the leadership
5 progression. I know most of the people within the
6 leadership positions within TEP are all wonderfully
7 well-grounded management people. So my concern for the
8 transition of leadership within the, within that
9 organization, I have the upmost confidence both in Jim
10 and then the leadership positions in behind him. So he
11 will be around for five years, and I'm absolutely sure
12 when Jim decides to go, whenever he decides to go, he
13 will be replaced with an extraordinary leadership
14 position. I have no doubt of that.

15 COM. MAYES: Just one follow up, Mayor.
16 Commissioner Mundell at the last public comment session
17 held up a couple very interesting charts, and they show
18 the way the structure of the company would look
19 post-merger, post-sale, and it very clearly shows that
20 there is a new layer on top of the current management
21 team. Have you had a chance to discuss these issues
22 with that layer, with KKR, with J.P. Morgan, and would
23 you want to?

24 MAYOR WALKUP: Of course, but again, I'm not
25 worried about this. I have been through it enough in my

1 corporate career to know through acquisitions there are
2 new layers, but the investment team I am sure is saying
3 we want the very best investment and best profitability
4 and protection of our investment. You do that by making
5 sure your management team is in place, that they're
6 allowed to understand and interface with local
7 leadership. So yes, we need to sit down and talk about
8 it, but again, I am very confident that the interests of
9 the community will be well served by this acquisition.

10 ALJ RODDA: Okay. Thank you, Mayor Walkup.

11 MAYOR WALKUP: Thank you very much.

12 ALJ RODDA: Next speaker, Jim Apperson.

13 MR. APPERSON: Good morning. My name is Jim
14 Apperson, A-p-p-e-r-s-o-n, and Ms. Rodda and
15 Commissioners, good to see you here this morning.

16 I am President and CEO of the Arizona
17 Chamber of Commerce which is a statewide
18 business-oriented public policy advocacy organization.
19 We have been helping grow Arizona's economy for over
20 30 years. I have personally been involved in public
21 policy work nearly 30 years myself including three years
22 with this Commission as a Staff member, and a two-year
23 tour of duty with your colleagues at FERC in Washington,
24 D.C. Please don't hold that against me.

25 During my four years at the Arizona Chamber,

1 we have been happy to produce an annual energy summit
2 that I think all of you have attended so that the
3 business leaders, elected officials, and the media can
4 learn about the importance of electric and natural gas
5 energy infrastructure to the economic future of our
6 state. I think that this clearly shows our commitment
7 to energy as a critical public policy issue.

8 Now, based on my years of experience in
9 energy matters, it's quite obvious to me that high
10 quality energy service is crucial to economic growth.
11 In fact, reliable utility service in our state is
12 considered by many economic developers to be one of the
13 top reasons for businesses to move to or expand within
14 Arizona.

15 I'm here to recommend your approval of the
16 proposed acquisition because I believe it will enhance
17 our economic development efforts on a statewide basis.
18 Clearly, an investment of this magnitude in a company
19 that serves both greater Tucson as well as a significant
20 part of rural Arizona makes a strong statement that our
21 state is a great place in which to do business.

22 I believe that your approval of this
23 proposed acquisition would also be an indicator of
24 strong, a strong continuing relationship with Arizona's
25 communities for many years to come. So with that, I say

1 thank you, and I'll be happy to answer any questions.

2 ALJ RODDA: Any questions?

3 MR. APPERSON: That's it? Thank you very
4 much.

5 ALJ RODDA: Thank you.

6 Next is David Lovitt.

7 MR. LOVITT: Good morning. I'm David
8 Lovitt, L-o-v-i-t-t.

9 Your Honor, Commissioners, thank you for
10 this opportunity to speak this morning. I'm the owner
11 of D.M. Lovitt Insurance Agency, and I'm on the board of
12 directors for Boys and Girls Club of Tucson. I'm a
13 third generation Tucsonan, and have been on the Boys and
14 Girls Club board for over 24 years, since 1980.

15 This morning, I am here to speak on behalf
16 of and in favor of TEP, TEP and their acquisition by
17 KKR, J.P. Morgan and Wachovia. I believe it's extremely
18 important that Tucson continue to have the corporate
19 presence of TEP which is one of the larger employers of
20 Tucson, in the City of Tucson, and it is clear that this
21 acquisition will allow this utility to continue to run
22 from Tucson with the same leadership it currently has.
23 This is important to myself and to the public because I
24 believe we'll still have the same great people to call
25 when needed, and it's important to the Boys and Girls

1 Club because of the tremendous support the clubs receive
2 from Tucson Electric Power, both financially, and TEP's
3 employees as volunteers to the Club. Their annual
4 financial contribution to the Boys and Girls Club is
5 substantial and extremely critical to our annual budget
6 and they provide literally hundreds of volunteers each
7 year to our various events and projects.

8 One of the nicest things TEP supports
9 100 percent is the Holiday Auction Spree for the youth
10 of the Boys and Girls Clubs. Hundreds of youth from all
11 of our clubhouses come to Robinson-May early on a
12 Saturday morning in December while the store is closed
13 for four hours to do holiday shopping for their family.
14 This is something that these youths would never have an
15 opportunity to do. TEP provides all of the funding and
16 all of the adult volunteers. With TEP's financial
17 contribution and Robinson-May's discounts, over \$25,000
18 of presents are provided to hundreds of families who
19 would have nothing or very little for the holidays.

20 We support the sale of TEP to KKR and urge
21 that you give your support. Thank you.

22 Any questions?

23 ALJ RODDA: Any questions from the
24 Commissioners? Okay. Thank you, Mr. Lovitt.

25 Richard White.

1 MR. WHITE: Good morning. I'm Richard
2 White. I'm a resident of Pima County. I'm also
3 executive director of the American Red Cross for
4 Southern Arizona. Thank you for this opportunity.

5 In this age of uncertainty, there's very few
6 things that really are certain. The question you posed
7 earlier about what can happen in the future, I think
8 five years is a pretty good bet right now. The Red
9 Cross' role throughout southern Arizona is keeping
10 families safe, and Tucson Electric Power/UniSource has
11 been a wonderful advocate for the Red Cross not just
12 financially but as a real source, literally a source of
13 power, both electrical power and power within the
14 community.

15 I'm going to echo what the Mayor and
16 Mr. Lovitt had said. It's critical to keep the current
17 management, it's critical to keep this organization
18 based in Tucson. With their volunteers, with their
19 corporate gifts, with their concern for the community,
20 they really stand out. The leadership Jim Pignatelli
21 has exhibited has been terrific, and I also echo what
22 the Mayor had said, as a director of an organization
23 that deals with corporate executives and management
24 throughout southern Arizona, this is not a company that
25 simply has one executive. The team that Jim has put

1 together is truly outstanding, and I would have full
2 confidence that any of several people who were to
3 succeed him at some point would be able to carry on as
4 competently as he has been carrying on.

5 With that, I would ask for your support for
6 your for the sale going forward. There is not a lot of
7 strong corporate presence in the southern Arizona
8 community. It's very important that we have Tucson
9 Electric Power/UniSource continue to stay here. I urge
10 your support.

11 Thank you.

12 COM. GLEASON: Question.

13 ALJ RODDA: Commissioner Gleason.

14 COM. GLEASON: Yes, having been in
15 corporations for lots of years, I'm back to this
16 five-year thing, and what I wanted to ask you is you, I
17 gather you have no assurance what your budget is going
18 to be five years from now, is that --

19 MR. WHITE: That's correct.

20 COM. GLEASON: Five years is -- what I'm
21 getting at is when we made these plans, again, that was
22 what we used to call the martini page. In other words,
23 it was kind of a hope and a prayer that five years --
24 would you agree that five years is a long way to plan
25 on, on this sort of thing?

1 MR. WHITE: The point that I'm making or
2 will remake is given the current management, that going
3 forward I would expect this to go on beyond five years.
4 To have, to have strong certainty for five years I think
5 is a real plus, but I see real stability going well
6 beyond five years with the current management.

7 COM. GLEASON: Thank you.

8 ALJ RODDA: Thank you, Mr. White.

9 Ray Clarke.

10 MR. CLARKE: Good morning. Clarke,
11 C-l-a-r-k-e.

12 To the Commissioners and Your Honor, it's
13 very easy for me to stand here this morning, because the
14 Tucson Urban League has publicly recognized TEP with our
15 community service awards, and TEP is an incredible
16 community leader. I'd just like to share with you some
17 of the reasons why the Tucson Urban League is here.

18 The Tucson Urban League serves over 50,000
19 individuals and families per year. We do that in a
20 number of ways: Work force development, education,
21 housing, case management, microenterprise, neighborhood
22 enhancements. Most of those 50,000 clients that we
23 serve come out of our case management department. That
24 department simply could not exist without TEP. It's a
25 department that provides utility assistance to low

1 income individuals in situations where virtually they
2 would have their power cut off if not for the assistance
3 of TEP.

4 Now, funding is absolutely important, and as
5 a non-profit, we certainly appreciate funding from TEP
6 and others. But the critical importance of TEP in this
7 community to non-profits is just not related to funding.
8 I think they do three things very well. Funding is one.
9 The volunteers would be another. And that's in the
10 corporation giving not only of its resources, money, but
11 of itself, and it's a strong commitment.

12 But there's a third area that I think is
13 just as important, and it has to do with training that
14 TEP has paid for for non-profits in this community,
15 training like organizational capacities that will enable
16 a non-profit -- and when you talk about five years, in
17 our world, one year is a long, long time. But they have
18 worked out a situation and identified an incredible
19 resource, capacity building in the non-profit
20 organizations, that will allow us the ability to help
21 ourselves to be able to plan beyond a year and hopefully
22 beyond five years.

23 The final thing I would like to share with
24 you and maybe the most important, I have been in this
25 community since 1969, my freshman year at the University

1 of Arizona. I spent 11 years as deputy director, Pima
2 County Juvenile Court, and then two years in the
3 governor's office. The last 18 years that I've served
4 under the Urban League, there's nothing in all of those
5 years that suggests to me that TEP is not an
6 organization of its word. Its word is of the highest
7 integrity. I have evidence in terms of my relationship
8 with TEP over the many years that I have been with the
9 Urban League that strongly indicate that this
10 organization will continue to be a strong community
11 leader.

12 Thank you.

13 COM. GLEASON: I have a question.

14 ALJ RODDA: Commissioner Gleason.

15 COM. GLEASON: Yes, I'm interested in your
16 payments to the, you know, to low income people of
17 power, electricity. Is that, that money comes to you
18 and then you pass the money on to the deserving folks?
19 Is that the way the system works?

20 MR. CLARKE: That's part of it. It's the
21 utility assistance, and these are individuals due to
22 their low income nature, a significant population of
23 Anglos, Hispanics, native Americans, African Americans,
24 and others simply don't have the ability to pay that
25 bill. And thanks to TEP, not only with the Tucson Urban

1 League, a host of nonprofits working in collaboration,
2 we're able to take our meager resources and make those
3 payments, that's correct.

4 COM. GLEASON: Yes, they, I understand
5 UniSource also has a Cares Program, at least they have
6 it up north. Do they have it down here to help pay for
7 low income utilities?

8 MR. CLARKE: Yes.

9 COM. GLEASON: Okay. Thank you.

10 MR. CLARKE: Thank you.

11 ALJ RODDA: Thank you.

12 Ignacio Barraza.

13 I can say welcome to Tucson to you.

14 MR. BARRAZA: Thank you so much. Good
15 morning. My name is Ignacio Barraza. The last name is
16 B-a-r-r-a-z-a. I am a member of the Nogales City
17 Council, and I'll make my comments brief.

18 On behalf of fellow Councilman Jose Luis
19 De La Ossa who could not be here today, we are issuing a
20 statement of support for the acquisition and merger of
21 UniSource. We believe the following aspects of the
22 transaction are going to be very positive for our
23 community, number one being that the investor group will
24 remain in the, the investor group will retain the
25 company's headquarters in southern Arizona. That to us

1 is extremely important. Senior management teams will
2 continue to lead the company and direct local operations
3 within the State of Arizona.

4 We have developed a very close relationship
5 with the senior management teams in place over the
6 eight-month period that UniSource has been in control of
7 the local utility provider in Nogales. We also believe
8 that the level of customer service that has been
9 provided by UniSource since its acquisition of the old
10 Citizens Utilities has been proven to be superior. Over
11 the course of eight months, they have invested anywhere
12 from 15 to \$20 million in capital improvements. That is
13 a substantial amount of money being pumped into a
14 community of our size. Also, UniSource has demonstrated
15 a strong commitment to charity organizations, and has
16 been a valuable contributor along with its employees in
17 the community.

18 I will give you a perfect example. The City
19 of Nogales is currently in the process of trying to
20 rehab its skateboard park which services many
21 underprivileged children in our community. The city did
22 not have money to be able to light that park.
23 Citizens/UniSource was kind enough to donate the
24 lighting equipment which was so very necessary to be
25 able to get our young people to utilize that park in the

1 evenings. So that is but one example of the many
2 positive things that we have been able to extract from
3 our relationship with UniSource in Nogales, and we are
4 looking forward to a long and continuous relationship
5 with them.

6 I myself was city manager of Nogales during
7 the '97 to 2000 period when we came before this
8 Commission to request relief from the extremely poor
9 service that was being provided by Citizens Utilities
10 back then. I can tell you that in the eight months that
11 UniSource has been at the helm, many of those problems
12 have been dealt with and the relationship is very, very
13 positive.

14 At this point, that will conclude my
15 comments, and again, Councilman De La Ossa and myself
16 support the merger for the reasons I stated and ask that
17 you all look favorably upon this item.

18 I will entertain any questions if you have
19 any.

20 ALJ RODDA: Commissioner Mayes.

21 COM. MAYES: Thank you, Councilman; thanks
22 for coming up.

23 I had a chance to be down in Nogales and had
24 a good public comment session down there. You just said
25 that you, you mentioned the difficult times that you had

1 prior to UniSource's takeover of the company there,
2 Citizens, correct?

3 MR. BARRAZA: That's correct, yes,
4 Commissioner.

5 COM. MAYES: And UniSource itself, TEP not
6 recently, but, you know, I think in the 1980s, maybe
7 early nineties had its own tumultuous period. Given
8 that fact, isn't that an argument against change? I
9 mean, given the fact that things are going so well, why
10 would you argue in favor, why would one argue in favor
11 of allowing a change of this magnitude?

12 MR. BARRAZA: Well, because first of all, I
13 believe that the merger and acquisition brings
14 additional resources to a well-grounded company already.
15 By allowing these resources to come into TEP/UniSource,
16 they will be able to reduce their debt and thereby free
17 up additional resources to be able to put back into the
18 system.

19 I myself believe change is always good and
20 change is always healthy. Once again, you know, the
21 fact that a condition of the merger is that management
22 teams are kept the same and that offices are kept in
23 southern Arizona to me indicates a positive, and I
24 believe that that in itself is a very strong argument
25 endorsing, for us to endorse the change.

1 ALJ RODDA: Thank you so much for coming up.

2 MR. BARRAZA: Thank you. Thank you very
3 much.

4 ALJ RODDA: Next speaker is Roy Dunton from
5 Kingman, someone else I can welcome to Tucson. Welcome
6 to Tucson.

7 MR. DUNTON: Good morning. I hope my ears
8 will work well this morning.

9 I want to thank you for having the meeting
10 so that we can express our views. By the way, my name
11 is Roy Dunton. I am a member of Mohave County Economic
12 Development Authority, been on the board for almost nine
13 years.

14 In our area, there's a great feeling of
15 distrust among Mohave County residents in regard to this
16 sale. For an example, three Commissioners mentioned
17 that they would do their best to change the source of,
18 or the location of this meeting so that it would be more
19 available to the people that would like to appear, and
20 to no avail. And holding this meeting in Tucson for a
21 week is not only inconvenient, but cost prohibitive for
22 many people who would like to attend. It's almost cost
23 prohibitive for our population to come here to Tucson.

24 It was suggested that the meeting be held in
25 Phoenix where it was more available to the citizenry.

1 Many people feel that in holding the meeting in this
2 area that UniSource and the bankers who wish to buy it
3 don't want any negative comments or intervenors to
4 appear. That's the way it appears to some of the, most
5 of the people in our area. And the suspicion was why
6 was the sale of Citizens Utilities authorized by the
7 Commissioners, and when the Judge knew that key
8 negotiations were in progress during or before to sell
9 to the New York bankers of J.P. Morgan. I believe the
10 name is Saguaro.

11 UniSource made the statements that they were
12 local people based in Arizona and it would be far
13 different from what it was for Citizens with their
14 headquarters in Stamford. They were also told that they
15 would be more satisfied because it was locally owned,
16 and it's just unbelievable to many people that during
17 this sale that it would be in the local best interest of
18 the ratepayers to have the headquarters in Tucson.

19 During all these negotiations, they also
20 said that it would be less costly because they wouldn't
21 have the headquarters in New York or some other eastern
22 area. And now, they want to put us right back into the
23 same position with the sale of UniSource to J.P. Morgan
24 out of New York.

25 Why would J.P. Morgan want to get into the

1 utility business? No doubt for profit. Why would they
2 invest \$660 million in a utility that was purchased for
3 roughly 180 million? And I realize that TEP wasn't
4 always involved in it, but who is going to pay the
5 difference between the original sale and the sale today?
6 Has J.P. Morgan been in the utility business before?
7 I've had people tell me that the bankers, the large
8 banks are gobbling up the utility businesses around the
9 nation, and maybe this is part of it. But who will pay
10 the profit or the difference between UniSource's sale
11 from Citizens Utilities and the buying price of Morgan?
12 There's only one place for them to get their money, and
13 that's the ratepayer.

14 What is the benefit for the public and the
15 ratepayer and the public in general in this sale to
16 J.P. Morgan? If this sale is not in the best interest
17 of the public, the Arizona Corporation Commission has
18 the obligation not to approve this sale. Economic
19 development in Kingman and Lake Havasu and now Flagstaff
20 has virtually been stopped due to the high electrical
21 rates. We have companies that employ 800, one company
22 of 800, and another company of 300 who was thinking of
23 moving from the area. It would be a devastating blow to
24 Mohave County, especially the Kingman and Lake Havasu
25 area. And this is due to the increase that we've had

1 already of 22 and a half percent on residential, and
2 about 25 percent for the industrial.

3 I can't imagine why a company would offer a
4 bonus to the stockholders to buy them out to buy
5 UniSource. We know that UniSource can't raise the rates
6 in our area for the next couple of years, but after
7 that, Katie bar the door. The barn doors are going to
8 be blowing off; they could be. They're going to recover
9 the money that they paid for over and above the value of
10 the stock, and there's only one place they're going to
11 get it. And it comes back to the same old question, who
12 pays, and that's the ratepayer.

13 I would like to see this deal rejected by
14 the Commission, and I want to thank you for allowing us
15 to be here.

16 ALJ RODDA: Thank you, Mr. Dunton.

17 Any questions? Thank you very much for
18 making the trip.

19 Oh, I'm sorry.

20 COM. MAYES: Roy, I appreciate your
21 comments, and I do appreciate you coming all the way
22 down here from Mohave, and I was one of those people who
23 wanted to at least try to see if we could get part of
24 the hearing in Phoenix, and unfortunately, things didn't
25 work out, but I did push hard to get streaming audio on

1 the Internet. I also pushed hard for a 1-800 number
2 which we haven't been able to get accomplished here in
3 Tucson, but we do have one down in Tucson.

4 But we did come up to Mohave, had hearings
5 in both Lake Havasu and Kingman which I thought were
6 very fruitful, and I have a lot of questions for the
7 parties that I formulated after those hearings. So I
8 hear your concerns. Frankly, you know, I'm from
9 Prescott, and this is a big issue in Prescott as well,
10 so it could easily have been, there's certainly a lot of
11 folks in Prescott who would like to have the hearings up
12 there.

13 MR. DUNTON: We appreciate the fact that the
14 full Commission Staff came to our areas. Having to come
15 down here, though, and I appreciate the website, but the
16 website just come up in the last couple days, and
17 really, people are not aware of it. And the ones who
18 would like to oppose or take the other side really don't
19 know about it. Is it in the newspaper or anything else,
20 that the website is available? I haven't read it if it
21 is.

22 ALJ RODDA: I just have to say for the
23 record that we have a number of intervenors from Mohave
24 County who are able to participate by the telephone, and
25 they were, I mean, they were parties, and are going to

1 be able to participate in the cross-examination of
2 witnesses, and I'm sure they'll advance their interests.
3 And so I think Citizens of Mohave County had an
4 opportunity to intervene. I understand it's a long way
5 from Tucson, but I just wanted to state there are some
6 people that are participating from Mohave County.

7 MR. DUNTON: As far as I know of, I think
8 there's only three people here from Mohave County that I
9 am aware of. But as I say, they have access to the
10 website, but what about those that don't have a website?

11 ALJ RODDA: I understand what you're saying.

12 MR. DUNTON: Thank you very much.

13 COM. MUNDELL: Roy, I have a couple
14 questions. Commissioner Mundell here.

15 There are lawyers as I understand it on the
16 phone that will be able to participate in this hearing
17 from Mohave County as the judge just indicated,
18 interactively, not just listening but be able to ask
19 questions, so I wanted to make sure that was clear.

20 The question I had, I didn't quite
21 understand your statement. I thought you said, I am
22 going to paraphrase, the judge knew that this sale was
23 pending when the UniSource purchase of Citizens was
24 taking place. Did you say that or did I
25 misunderstanding you?

1 MR. DUNTON: That's what I understand. I
2 don't see how the Judge could not know about it when
3 everything was being pulled together in a very short
4 period of time at the end there.

5 COM. MUNDELL: Well, the only way -- I mean,
6 I don't know what you're saying, but the only way I
7 think the Judge would know is if there was testimony
8 presented in the hearing to that effect, but we'll delve
9 into that as this matter moves forward. I mean, those
10 are some questions that I'm sure some of the
11 Commissioners have. And as you know, we did hold public
12 comment up in Kingman and Lake Havasu, and at those
13 hearings, I asked some of the same questions that you
14 just indicated, why is this acquisition, merger, sale,
15 whatever term you want to use in the public interest,
16 and how are customers benefited. We know that the
17 shareholders are benefited with a 30 percent premium.
18 We know the executives of UniSource are going to benefit
19 with compensation. And then lastly, we know, I am
20 assuming that the purchasers have done their due
21 diligence and have indicated, come to the conclusion
22 based on that due diligence that this is in their best
23 interest to have this application in front of us to make
24 the purchase. So there are a lot of unanswered
25 questions we will delve into over the next three or four

1 days to ferret those things out. We appreciate your
2 coming down to participate, but this is just the
3 beginning of this process.

4 MR. DUNTON: Thank you very much, and I hope
5 you take a good, strong look, and I'm sure you will.
6 Thank you again.

7 ALJ RODDA: Thank you. And the next speaker
8 is Mr. Donald Van Brunt.

9 MR. VAN BRUNT: Van Brunt is V-a-n
10 B-r-u-n-t.

11 I have a statement, but I also have a
12 statement from a person who could not be here, Buster
13 Johnson, who is supervisor in Mohave County District 3
14 would like me to read his statement into the record
15 before I read my own.

16 ALJ RODDA: I just caution you when you are
17 reading to read slowly. People tend to speed up when
18 they are reading.

19 MR. VAN BRUNT: I have a copy for the
20 reporter, if you wish.

21 ALJ RODDA: Excellent. Thank you so much.

22 MR. VAN BRUNT: Honorable Chairman and
23 members of the Commission, thank you once again for your
24 opportunity to address the Commission on the matter of
25 the leveraged buyout of UniSource. I am afraid for our

1 ratepayers with this proposed leveraged buyout that
2 their rate would escalate beyond their ability to pay
3 for the basic necessities of life. We all say we are
4 working for ratepayers. I strongly feel that if you put
5 utilities in the hands of the private industry, the only
6 ones who will benefit from the merger will be the
7 shareholders. I would remind you that the transaction
8 must benefit the ratepayer first.

9 As you know, our businesses are struggling
10 with current electric rates, and many have decided to
11 relocate. This is one way, this in no way makes the
12 quality of life in Mohave County better. It only makes
13 it more difficult for people to find good paying jobs.

14 The ripple effect that this merger will
15 cause goes far beyond higher rates. Even though we are
16 told rates will hold until 2008, we don't know what will
17 happen after that date. Businesses are contemplating
18 moving out of our county due to the high energy rates
19 that exist today. Good jobs will and are being
20 increasingly harder to get, causing our young people to
21 leave our communities and look for work in other cities
22 and states. Along with the jobs that leave, so does the
23 opportunity of affordable health benefits. As
24 population decreases, excuse me, as population decrease,
25 so do property values, so property values decrease, so

1 do the services paid for property taxes.

2 Over the years, Arizona has worked hard to
3 attract good business to the state which in turn
4 attracts a very viable work force. Now that we have
5 those businesses, do we take them by the throat and
6 choke the life out of them, the life that we asked them
7 to bring to our great state? Our homeowners,
8 government, schools, and down the list are struggling
9 with the current rates.

10 The guiding principle in the sale of a
11 public utility is is it in the best interest of the
12 public. I don't believe so. While I have stood before
13 you many times debating rate increases proposed by
14 Citizens and now UniSource, today I would like to say
15 that UniSource has done a very good job in bringing TEP
16 to a better financial picture today. This management
17 staff has worked hard. They have made great strides in
18 their bottom line and for good reason. They have held
19 financial interest in the company. This buyout will do
20 away with that ownership. This buyout does not
21 guarantee that management Staff that is in place today
22 will continue to run the company.

23 Saguaro has no history in operating a public
24 utility, and this gives me reason for concern. When you
25 add to the higher debt leverage that will take place

1 with the merger, the picture gets darker. This buyout
2 is at an inflated price. Saguaro is purchasing
3 UniSource at 68 percent over their book value. The only
4 possible way to get a return for their investment is
5 through rate increases, and the investors are their
6 concern, not the ratepayers.

7 In RUCO's report, they agreed with our
8 assessment that there will be no benefit to the
9 ratepayers. It appears that Saguaro is requiring
10 100 percent of TEP's annual earnings to service
11 Saguaro's debt. There will be nothing left to put back
12 into the communities, and all the efforts that UniSource
13 has put forth to build a strong community bond as well
14 as financially sound utility will be wasted.

15 I ask you to consider that in the best
16 interest of the taxpayers and not to allow this sale.
17 There is no financial gain to be made by ratepayers, no
18 increase in service, no improvement in management, no
19 possibility of lower rates. I ask you not to approve
20 this sale. We are not happy with the rates we are
21 paying now, but the devil we know is better than the
22 devil we don't know.

23 Thanks for your time. Buster D. Johnson,
24 Supervisor, District 3.

25 ALJ RODDA: Thank you. We'll get a copy

1 from you.

2 MR. VAN BRUNT: Chairman and members, I
3 thank you for the opportunity to address you on the
4 UniSource buyout.

5 As you are aware, we have lost several
6 industries in Mohave County, raising our unemployment
7 and reducing our gross income, yet we continue to
8 increase in population at an alarming rate. It is clear
9 the population growth without basic employment increase
10 creates a county-wide financial deficit.

11 This proposed leveraged buyout by Saguaro
12 can only make industrial attraction to Mohave County
13 more difficult. We are assured by UniSource in the
14 buyout of Citizens Utilities that we would now have
15 local ownership, local concerns, and local people at all
16 levels to work with while all the time they knew they
17 were talking to Saguaro about another sellout. Can you
18 blame the ratepayers for being suspicious of this sale?
19 Saguaro said local management staff will continue to run
20 the company, but past experience with Stamford,
21 Connecticut Citizens Utilities tells us clearly local
22 management does not make the decisions that count.

23 The required, the law requires that the
24 buyout must be in the best interest of the public. The
25 best interest of the buyer is easy to see, but no one

1 has in any way, shape, or form been able to show the
2 public where this proposal will benefit them. Our
3 schools, our hospitals, our industries, our retailers,
4 our various city and county and state agencies can all
5 show you the detriment caused them by the last buyout,
6 but none of them can see any benefit to them in what is
7 being proposed here. This proposed buyout at a
8 ridiculous price will have to be paid for in due time by
9 the ratepayers. Money in the utility business can only
10 come from one place, the ratepayers. Paying more for
11 utilities cannot be considered a benefit to the public.
12 We can't afford the rates we're paying now.

13 I ask you to look at the best interests of
14 the ratepayers and reject the proposed buyout. Thank
15 you for your time and consideration, Donald Van Brunt.

16 ALJ RODDA: Thank you. Any questions for
17 Mr. Van Brunt?

18 All right. Thank you, Mr. Van Brunt.

19 MR. VAN BRUNT: Thank you.

20 ALJ RODDA: That's all the speaker slips I
21 have. Is there anyone else who wishes to make comment
22 at this time?

23 Okay. Then I'm going to take a five-minute
24 recess, and then we're going to start with opening
25 statements. And for the intervenors in Mohave County

1 who are listening in on the Webcast, would you please
2 call back in so I can talk to you on the number I gave
3 you?

4 Five minutes.

5 (A recess ensued.)

6 ALJ RODDA: Let's come back to order.

7 We are back on the record, and we are also
8 back online, and I just want to mention that evidently,
9 our west Webcasting is going beautifully, and that these
10 microphones are incredibly sensitive. So if I forget to
11 turn off the Webstream during breaks, they're picking up
12 everything that goes on here, which is probably really
13 annoying to all those people on line. So we'll try to
14 remember that.

15 My intent is to start with opening
16 statements, and then break for lunch and start with
17 Mr. Pignatelli after lunch. And with that, I'll ask
18 Mr. Heyman, do you have an opening this morning?

19 MR. HEYMAN: Yes, I do.

20 Good morning again, Commissioners, and Judge
21 Rodda. For the record, my name is Ray Heyman from the
22 law firm of Roshka Heyman & DeWulf, and I represent
23 UniSource Energy Corporation and its affiliates. In
24 attendance with me From UniSource energy is Mr. Jim
25 Pignatelli, the chairman and chief executive officer,

1 and other members of the senior management treatment. I
2 also want to introduce to you representatives of the
3 limited partners who are in attendance: Mr. Scott
4 Stuart and Marc Lipschultz are here from KKR; Mr. Chris
5 Behrens from J.P. Morgan Partners; Mr. Wellford Tabor
6 from WCP; and Mr. Fred Rentschler from Sage Mountain,
7 LLC.

8 The purpose of this hearing is for the
9 Commission to determine whether it will approve the
10 change in ownership of UniSource Energy. Currently,
11 UniSource Energy is a publicly-traded company. Prior to
12 the announcement of this transaction, approximately
13 70 percent of UniSource Energy stock was owned by
14 institutional investors. Upon closing of this
15 transaction, all of the shares of UniSource Energy will
16 be owned by Saguaro Utility Group. Some of these shares
17 will be held for management participation. UniSource
18 Energy shareholders have already approved the merger.
19 The Federal Trade Commission review process has been
20 favorably and successfully completed, and we expect
21 favorable rulings from the Federal Energy Regulatory
22 Commission and the Securities and Exchange Commission.

23 The standard that this Commission has
24 established for determining whether to approve the
25 reorganization of a utility holding company is clear.

1 It is longstanding. The standard is plainly stated in
2 the Affiliated Interest Rules that this Commission
3 created, caused to be published in the Arizona
4 Administrative Code which are legally binding and upon
5 which UniSource Energy and Saguaro have relied.
6 Affiliated Interest Rule 14-2-8003.C states, "At the
7 conclusion of any hearing on the organization or
8 reorganization of a utility holding company, the
9 Commission may reject the proposal if it determines that
10 it would impair the financial status of the public
11 utility, otherwise prevent it from attracting capital at
12 fair and reasonable terms, or impair the ability of the
13 public utility to provide safe, reasonable and adequate
14 service."

15 No one disputes that this standard is
16 applicable to this proceeding. For example, Commission
17 Staff's consultant in his direct testimony referred to
18 this standard as a no net harm rule. And in the past,
19 when the Commission has determined that it has been in
20 the public interest to do so, it has attached conditions
21 to its approval of a holding company reorganization to
22 insure that no harm does occur. In fact, in this
23 proceeding, UniSource Energy is proposing over 40
24 conditions to provide additional assurances and
25 verification that no harm will occur.

1 Let me summarize briefly how this merger
2 meets the No-Harm Rule. First, the merger will not
3 impair the financial status of TEP, UNS Gas, or UNS
4 Electric. None of these utilities will incur any
5 additional debt as a result of the merger. To the
6 contrary, as a result of the merger, there will be an
7 immediate infusion of, into TEP of approximately
8 \$263 million which will be used to pay down debt, and an
9 improvement in the company's debt equity ratio from 25
10 percent equity to 40 percent equity. This improvement
11 to the TEP capital structure will improve its financial
12 status.

13 Second, the merger will not impair the
14 ability of TEP, UNS Gas or UNS Electric to attract
15 capital at fair and reasonable terms. The merger will
16 actually improve their ability to attract capital at
17 fair and reasonable terms. A financially improved TEP
18 post-merger will be in a better position to negotiate
19 better terms for necessary capital than before the
20 merger. Also, as a result of the merger, UNS Gas and
21 UNS Electric will have the benefit of a \$40 million,
22 five-year revolving loan. The financial relationships
23 and the expertise of the investors will enhance the
24 utility's ability to attract capital. Indeed with their
25 investment in UniSource Energy's service territories,

1 the investors will be a new and valuable financial ally
2 for TEP, UNS Gas, and UNS Electric.

3 Let me refer to a real life example.

4 Subsequent to the announcement of the merger, TEP
5 voluntarily refinanced a \$400 million credit facility
6 with the assistance of the investors and using lenders
7 presented to TEP by the investors. The new credit
8 facility has terms that are significantly better than
9 the previous credit facility and will result in
10 substantial savings to the utility.

11 Third, the merger will not impair but will
12 improve TEP's, UNS Gas' and UNS Electric's ability to
13 provide safe, reliable, and adequate service.
14 Conditions to the merger will insure continuity of
15 UniSource Energy senior management, business plan, and
16 corporate philosophy including community and charitable
17 contributions. Also, one proposed condition of the
18 merger will obligate TEP, UNS Gas, and UNS Electric to
19 spend not less than \$1.5 billion in operating and
20 maintenance expenses and capital expenditures for the
21 years 2005 to 2008.

22 Another condition will require TEP to make
23 at least \$400 million of voluntary debt and lease
24 prepayments and buybacks prior to December 31st, 2008.
25 These conditions and the other merger conditions improve

1 the ability of TEP, UNS Gas and UNS Electric to provide
2 service presently and during future periods of
3 anticipated growth.

4 We've seen a tendency in the prefiled
5 testimony and discovery to suggest that even if the
6 merger satisfies the No-Harm Rule, the Commission should
7 extract something more from UniSource Energy, almost as
8 a quid pro quo for approving the merger. Some
9 intervenors erroneously want Certificates of Convenience
10 and Necessity to be amended in this proceeding. Public
11 commenters have suggested that you tie your approval to
12 demand side management terms and conditions, and still
13 others have suggested that the Commission should see if
14 customers can receive some additional immediate economic
15 benefits in this proceeding. Commissioners, the idea of
16 tying non-merger related conditions, economic or
17 otherwise, to your approval of the merger has nothing to
18 do with the No-Harm Rule. You will not find any such
19 requirement anywhere in Arizona law. This is not a CC&N
20 hearing. This is not a DSM workshop, although as you
21 know, we already are supportive participants in the
22 ongoing DSM workshops. You have other dockets, other
23 decisions, and other rules that allow you to examine and
24 adjudicate those and other issues.

25 UniSource Energy steadfastly believes that

1 the merger fully satisfies the No-Harm Rule and will be
2 a positive thing for all affected parties. UniSource
3 Energy negotiated the terms of the merger agreement in
4 such a way as to protect its utility operations. The
5 stipulated conditions that are set forth in Section 6.06
6 of the merger agreement which you have in front of you
7 in your packet and which I placed on the board here in
8 front of me are designed to make sure that the utilities
9 and even more, the communities and customers served by
10 UniSource Energy would not be harmed but be benefited by
11 the merger.

12 The stipulated conditions in general terms
13 provide for UniSource Energy's management to remain in
14 place and to continue in its management role. The
15 UniSource Energy companies will continue their presence
16 in Arizona and continue to be involved in charitable and
17 community activities, and TEP's debt equity ratio will
18 be improved to 40 percent by an equity contribution of
19 up to \$263 million.

20 Now, in addition to the stipulated
21 conditions, UniSource Energy has presented over 40
22 proposed conditions in the rebuttal testimony of
23 Mr. Pignatelli. These are also in your packet and are
24 on the second board that's in front of me. These
25 proposed conditions are designed to provide additional

1 assurances and a process for verification that the
2 merger will continue to satisfy the No-Harm Rule under
3 even extreme circumstances. These proposed conditions
4 address financial integrity and ring fencing conditions,
5 affiliate relationships, governance, oversight and
6 community presence, and the nonrecoverability of merger
7 and affiliate costs. Furthermore, in Mr. Pignatelli's
8 witness summary, UniSource Energy has expanded on some
9 of the proposed conditions in response to Commission
10 Staff's surrebuttal testimony. Mr. Pignatelli will
11 address these in more detail when he takes the stand.

12 Commissioners, as I said before, the merger
13 now has over 40 conditions attached to it. These
14 conditions have been designed with the input of the
15 Commission Staff to provide assurance and verification
16 that if various unexpected situations arise in the
17 future such as financial problems at the holding company
18 level, TEP, UNS Gas and UNS Electric will suffer no
19 harm.

20 The Commission Staff's consultant in his
21 direct testimony analyzed a number of similar
22 transactions that have already been approved in Texas,
23 Oregon, Illinois, and Iowa. Many of the proposed
24 conditions in this case were patterned after conditions
25 that were adopted in those similar transactions. In

1 fact, the conditions proposed in this case are an
2 amalgam of all the conditions proposed in those prior
3 transactions, and I think that it is important to note
4 that all of the similar transactions were approved by
5 their public utility commissions and passed the no harm
6 standard.

7 Now, Commissioners, this is not the first
8 utility reorganization case that we have participated in
9 with you. From prior experience, and from your written
10 questions in this docket, we think we've learned some
11 lessons, and we've drawn some conclusions. First, we
12 are confident that you are reviewing and will continue
13 to review the merits of the merger and its conditions
14 utilizing the proper standard. Second, we recognize
15 that you want to be comfortable that any condition that
16 you approve related to the merger is purposeful,
17 realistic, verifiable, and mutually understood. And
18 third, we know that you want to insure that after the
19 merger, UniSource Energy and the investors will live up
20 to the conditions that you approve. With these lessons
21 in mind, UniSource Energy offers the merger conditions
22 to serve as a framework for trust with verification.

23 UniSource Energy and the investors have
24 attempted in good faith to anticipate and address your
25 concerns from the earliest negotiation stages of the

1 merger agreement. That is the reason we entered into
2 the stipulated conditions. That is why we have offered
3 the proposed conditions in response to Commission
4 Staff's concerns. Make no mistake about it: Commission
5 regulation of UniSource Energy utility affiliates has
6 been, is, and will continue to be an integral part of
7 the UniSource Energy post-merger plan.

8 Commissioners, as I stated, the merger not
9 only satisfies the No-Harm Rule, it far surpasses it by
10 providing quantifiable, real, and significant benefits
11 for customers, communities, and shareholders. A
12 stronger TEP, bolstered by the infusion of \$263 million,
13 is better equipped today to meet its responsibilities to
14 provide safe, reliable, and adequate electric service to
15 customers. Commission Staff's consultant stated in his
16 surrebuttal testimony, "Short-term improvement to TEP's
17 equity capital and equity ratio is a positive feature of
18 the proposal before the Commission in these
19 proceedings." The availability of a revolving credit
20 line for UNS Gas and UNS Electric under favorable terms
21 better positions those utilities to meet their
22 responsibilities to provide safe, reliable, and adequate
23 electric service to customers.

24 I also previously mentioned proposed
25 conditions that will legally obligate the UniSource

1 Energy utilities to spend not less than \$1.5 billion in
2 O & M and capital expenditures between 2005 and 2008,
3 and will require TEP to make at least \$400 million of
4 voluntary debt and lease prepayments and buybacks prior
5 to December 31st, 2008. Without the merger, these
6 actions are plans, projections, and goals. However, by
7 approving the merger, the Commission will be converting
8 those plans and projections into firm guarantees for
9 customers. The impact of these two conditions alone is
10 almost \$2 billion dedicated to maintaining and improving
11 the utility's ability to provide service to customers in
12 the near term.

13 UniSource Energy will be presenting the
14 direct and rebuttal testimony of Mr. James S.
15 Pignatelli, its chairman and CEO. We will also be
16 presenting the rebuttal testimony of Mr. Scott Stuart of
17 Kohlberg Kravis Roberts, and additionally we are
18 presenting a panel of Mr. Stuart and representatives of
19 the limited partners in Saguaro Utility Group to answer
20 your questions.

21 Commissioners, we think that it is very
22 significant that Wall Street has come to Tucson,
23 Nogales, Prescott, Kingman, and Flagstaff, Arizona. We
24 believe that the investors have demonstrated good faith
25 by committing immediately to invest \$263 million into

1 TEP to keep UniSource Energy's statewide presence, to
2 retain local management and control, and to agree to
3 over 40 conditions to provide assurances and
4 verification that TEP, UNS Gas, and UNS Electric will be
5 able to provide safe, reliable, and adequate service to
6 customers. We believe that the investors' appearance at
7 this hearing will help you understand their commitment
8 to the success of UniSource Energy and its affiliates.
9 We believe that by approving this merger, you will be
10 doing the right thing for the communities served by
11 UniSource Energy, and you will be sending the right
12 message far and wide that the State of Arizona and
13 private investors can work together to foster economic
14 growth with adequate customer protection.

15 Commissioners, we ask that you consider the
16 terms and conditions that have been proposed in
17 connection with this merger, that you consider the
18 benefits of the merger, that you apply the proper legal
19 standard set forth in your Affiliated Interest Rules,
20 and that you approve the merger.

21 Thank you.

22 ALJ RODDA: Thank you, Mr. Heyman.

23 Mr. Meek, do you have an opening this
24 morning?

25 MR. MEEK: Yes, Your Honor.

1 Thank you, Your Honor, members of the
2 Commission. Walter Meek, President of the Arizona
3 Utility Investors Association.

4 AUIA has been involved as an intervenor or
5 witness, in fact, I think in every instance as an
6 intervenor in every major merger or acquisition that has
7 come before this Commission since 1998. Some of them
8 have been good; some of them have been not so good.
9 They have included the sale of U S WEST to Qwest, the
10 proposed sale of Southwest Gas; the transfer of Citizens
11 Water properties to American Water, and the sale of gas
12 and electric operations to UniSource. There were
13 several other smaller transactions involving smaller gas
14 and telephone exchange operations. In every one of
15 those cases, the acquisition was by another company that
16 was nominally in the same business as the acquiree, or
17 at least they were, you know, in the utility business
18 generally. And for that reason, whether they were good
19 or bad really, those transactions made intuitive sense I
20 think to most of us.

21 Here we have a situation that Commissioner
22 Mundell has described as a matter of first impression.
23 What's different, I believe, is that the purchasers here
24 are a group of investment entities that are not in the
25 business of operating utilities, and it makes us ask

1 what's this about. It makes us a little suspicious
2 because it's outside of our normal experience.

3 Now, Your Honor, it's obvious that AUIA's
4 shareholders have much to gain from this transaction.
5 It would be extremely unusual for a company's
6 shareholders or elected board of directors to approve a
7 sale that didn't produce shareholder benefits, but I
8 hope you and the Commission will believe me that AUIA
9 would not support an acquisition if it were evident to
10 us that it would harm UniSource customers or would
11 inflict damage on the local or state economy, and we
12 don't think either of those things are true here.

13 Now, Commissioner Mundell and Mayes among
14 others have said this is an extremely important case,
15 and they're right. I think I can say that AUIA has
16 studied this case, this deal, more carefully than most
17 of the other acquisitions that I mentioned. We believe
18 along with Mr. Heyman that the Commission is bound by
19 the standard contained in AAC R14-2-803.C which he has
20 posted for you here, the so-called no harm standard, and
21 we believe this transaction will not harm utility
22 customers and in fact will likely produce economic
23 benefits to TEP customers. Apart from that, we believe
24 that any lingering concerns that you may have about this
25 transaction can be effectively mitigated by the many

1 conditions that have been proposed and/or accepted by
2 the applicants.

3 Now, from a perspective of a retail
4 shareholder, this transaction similarly trades one group
5 of institutional investors who control ownership for
6 another group. Like it or not, the ownership of most
7 utilities today are dominated by institutions and most
8 retail shareholders do not have a significant influence
9 on policy. Unless there is something in the background
10 of these investors that would make them unfit to own a
11 public utility in Arizona, we see no basis for opposing
12 this ownership. In fact, based on the incredible amount
13 of investigation and due diligence that this group of
14 investors has done, it is very likely that they are
15 going to be a more constructive group of owners than
16 your typical roster of institutional investors.

17 For my last point, I'd like to focus on sort
18 of the bigger investment picture. The limited partners
19 in this case are very large and respectful, respected
20 players in the worldwide investment scene. They are
21 prepared to invest not only in the business enterprise,
22 but in the communities that that enterprise serves. As
23 Mr. Heyman noted, he stole my lines, by the way, that
24 means not only Tucson, but communities like Kingman,
25 Patagonia, Nogales, and yes, even Prescott. I think

1 this is a, that is a very strong statement about the
2 efficacy of Arizona as a place to invest.

3 On the other hand, if the Commission is
4 unable to accept a reasonable set of conditions, and if
5 it rejects this transaction due to some continuing
6 discomfort with it, that would send the worst possible
7 signal to the investment community and which I believe
8 could have a chilling effect on infrastructure
9 investments across the state for some period of time.

10 At the end of the day, AUIA is sure that you
11 will reach the appropriate decision in this matter and
12 approve this transaction.

13 Thank you.

14 ALJ RODDA: Thank you, Mr. Meek.

15 Mr. Enoch, do you have an opening this
16 morning?

17 MR. ENOCH: Yes.

18 Good morning, Your Honor, Commissioners
19 Mayes, Mundell, Gleason. Again, my name is Nicholas
20 Enoch with the law firm of Lubin & Enoch in Phoenix, and
21 in these proceedings we represent Locals 387 and 769 of
22 the International Brotherhood of Electrical Workers.

23 Before I go too much further, and so that
24 it's clear for the record, I would like to briefly
25 explain who the entities are that I represent and who I

1 don't represent as well. Local 387 is a labor union, I
2 believe it's office is actually on Seventh Street. It
3 represents a large number of employees of numerous
4 regulated utilities in the state, the largest of which
5 is APS. And then there's a variety of smaller ones like
6 Arizona Water Company just had one at the Corporation
7 Commission, and several others. Local 387 in this case
8 is the union which represents the employees of
9 UniSource, formerly known as Citizens Communication, in
10 Santa Cruz County. They have one collective bargaining
11 agreement for that unit down there which was Citizens.

12 So to give you a little brief union
13 democracy in the IBEW, the primary elected official of
14 the local is called a business manager. The business
15 manager for Local 387 is actually a short-termer. He's
16 leaving, retiring at the end of the month. The incoming
17 business manager for Local 387 has joined me today,
18 however. His name is Bob DeSpain. I don't know if he
19 should be congratulated or receive condolences, but Bob
20 will be starting July 1st, so you will probably be
21 seeing more of him in the months and years to come.

22 The second union that I represent in this
23 proceeding is Local 769 of the International Brotherhood
24 of Electrical Workers, which is a separate legal entity.
25 Its offices are also in Phoenix at a different location

1 off of Thomas. Local 769 also represents a large number
2 of employees at regulated utilities in the state, most
3 notably of which would be Southwest Gas. However, in
4 this proceeding, Local 769 represents the employees of
5 UniSource which is also formerly known as Citizens
6 Communications Company, except these are the employees
7 in Mohave County.

8 If you recall, Local 769 was an intervenor
9 in the case which led up to this one, I suppose, the
10 UniSource/Citizens merger, and in fact, in that case
11 actively supported and spoke in favor of that merger.
12 The business manager for that local is a gentleman by
13 the name of Joel Bell. Joel would have liked to have
14 been here today, but as things would be, he's actually
15 in contract negotiations with UniSource in northern
16 Arizona, so he was unable to attend.

17 A third IBEW Local which fits into this
18 picture is IBEW Local 1116 which is in Tucson. Now, I
19 did notice that there is at least one letter in the
20 docket from IBEW Local 1116 from an employee. I do not
21 represent IBEW Local 1116 in these proceedings. So that
22 you know, that is the union which represents primarily
23 the employees of Tucson Electric. So I'm going to
24 endeavor as best I can over the next couple of days not
25 to collectively refer to my clients as the IBEW because

1 that may not actually accurately reflect who I do and do
2 not represent.

3 Moving on to the position of my clients in
4 this case, Locals 387 and 769 as we are here today still
5 have some remaining questions regarding the proposed
6 acquisition, and there are some issues in which they
7 believe need to be more fully developed here at the
8 Commission. First and foremost among these issues are
9 the concerns, I hate to call them concerns, is the
10 question posed by Commissioner Mayes in her March 24th
11 letter to the docket, and in particular on page 2 under
12 I think you call it the second issue basically dealing
13 with what is going to happen to the employees down the
14 road. Some secondary issues that we also are interested
15 in learning more about were also addressed by
16 Commissioner Mundell even this morning in response to
17 the comments by the gentleman from the Mohave County
18 Redevelopment Authority.

19 To be clear, at this date, Locals 387 and
20 769 are not prepared to either express their support or
21 their opposition to the acquisition. Much like you, the
22 Commissioners, we'd like to hear the testimony and weigh
23 the evidence over the next couple days and then
24 afterwards, we will certainly be prepared to articulate
25 what our position is. But as of now, we do have some

1 remaining questions.

2 My final comment is to much discussion, and
3 rightfully so in these Commission cases, is the concern
4 of the patrons of public service corporations. I always
5 like to point out, however, that under the Arizona
6 Constitution, Article 15, Section 3, the interests of
7 the employees of public service corporations are put on
8 par with those of patrons, and as a side note, I would
9 note employees are actually listed before patrons in the
10 Constitution. But nevertheless, to be more modest, the
11 view is that they are put on par.

12 So with that in mind, we thank you in
13 advance for your consideration of this obviously very
14 important matter, and that's all. Thank you very much.

15 ALJ RODDA: Thank you, Mr. Enoch.

16 Mr. Robertson, do you have an opening this
17 morning?

18 MR. ROBERTSON: Thank you, Your Honor,
19 Commissioner Mundell, Commissioner Gleason, Commissioner
20 Mayes. My name is Lawrence V. Robertson, Jr.

21 As you and the members of the Commission who
22 are in attendance today are aware, I often have occasion
23 to appear before the Commission representing a client or
24 clients. In this occasion, I am appearing in a personal
25 capacity representing myself and my wife as ratepayers

1 of the company.

2 Shortly after I filed the application for
3 leave to intervene, I was contacted by a representative
4 of the applicants and asked basically, "Why are you
5 really intervening," and my response was really as a
6 matter of personal interest. And I mean nothing
7 pejorative when I allude to that. It's by way of
8 explanation.

9 At the time, I explained we were gas and
10 electric customers of UniSource in Santa Cruz County,
11 and in my Tucson office I am also indirectly a customer
12 of Tucson Electric Power. But as I thought more about
13 it, there are really three reasons I wanted to be a
14 participant in this proceeding, and I want to briefly
15 cover each of those.

16 First of all, as ratepayers of both TEP and
17 UniSource, I am interested in what effect the
18 transaction and the resulting organizational changes
19 might have upon the quality of service we receive, the
20 reliability of that service, and the cost of that
21 service.

22 Secondly, and this goes a little bit further
23 into my background, and the members of the Commission
24 may not be aware, during the late eighties and the early
25 nineties, I spent three and a half years at the

1 Department of Energy, and one of my responsibilities was
2 supervising the legal group that provided legal services
3 to the Conservation and Renewable Energy Program. And
4 at that time, that was the second largest program office
5 at DOE second only to their weapons program. And during
6 that period, I had a utility background prior to that, I
7 became a very firm believe in the roles of demand side
8 management, renewables, other less traditional
9 techniques have in my view in the resource portfolio of
10 electric utilities both now and as they move forward
11 into the future. So I'm interested in ascertaining the
12 current management thinking with regard to the role of
13 those strategies and technologies as well as the
14 investors' thinking and how the proposed transaction and
15 resulting organizational changes might impact the
16 opportunity for those sort of strategies and
17 technologies to be incorporated into future planning and
18 activities of the utilities here before you today.

19 The last reason I wanted to be involved is
20 also a very personal one, going back even further. In
21 the fifties and early sixties, my father represented
22 Tucson Electric Power on a number of significant
23 lawsuits including the famous Trico litigation. I
24 subsequently in the 1970s for approximately six years
25 had the honor and privilege of being selected to be the

1 company's first in-house general counsel and to organize
2 its legal department. In fact, I'm delighted one of its
3 members of senior management who I hired is sitting in
4 the audience today.

5 And the last reason, and this is also very
6 personal, but it goes to why I really am interested in
7 what is best for Tucson Electric Power and its other
8 facilities is that in the 1950s and 19, early 1960s, I
9 served as a groundman or what was then called a grunt on
10 one of the company's troubleshooting crews for three
11 summers during the electric storm season. So I have a
12 lot of familiar and fond memories of the company, and
13 I'm very interested in what is best for it.

14 I don't have a view for or against the
15 proposed transaction and the resulting organizational
16 changes at this time. I hope to become informed during
17 the course of the hearings and will have a view by the
18 time they have been concluded.

19 I did want to offer one last brief comment
20 that goes to Mr. Heyman's opening statement and his
21 recitation of the No-Harm Rule. I think it's important
22 that we keep in mind the language there that says, "The
23 Commission may reject the proposal if it determines,"
24 and the rule goes on to cite three different criteria or
25 decision-making considerations. But I would

1 respectfully submit the Commission is not obligated to
2 approve a given proposal if it finds those criteria are
3 satisfied. Those represent minimal standards. I think
4 in the Commission's discretion, the rule in spirit would
5 go on to read, "and would otherwise be in the public
6 interest," and I think that's also before you in
7 connection with your consideration of this application
8 and the evidence you will be receiving and the arguments
9 which you will be hearing.

10 And one final point, I thought Mr. Enoch had
11 a very nice touch in his opening remarks, and that is I
12 also would like to thank you for your attendance here in
13 Tucson and the attention I know you will be giving for
14 this matter.

15 Thank you.

16 COM. MUNDELL: Just briefly, I learned a lot
17 about you today, Mr. Robertson. I was going to ask, you
18 raised it again, and I'll just say hopefully counsel can
19 address it, the No-Harm Rule that's on the easel,
20 because as I understand it, we have a case pending in
21 the Court of Appeals that deals with the standard and
22 how the interplay of the public interest standard
23 interplays with the No-Harm Rule. So I think that's
24 important to note and maybe we can have some discussion
25 of that. Mr. Robertson alluded to it, and Mr. Heyman

1 obviously has brought it to our attention, but I think
2 there may be an interplay between the rule and the
3 constitutional provision and the cases pending in the
4 Court of Appeals in the Arizona-American case as I
5 recall.

6 ALJ RODDA: Thank you, Commissioner.

7 Mr. Magruder, do you have an opening
8 statement this morning, or it might be afternoon
9 already?

10 MR. MAGRUDER: Yes, I do. Good morning,
11 Judge, good morning, Commissioners. My name is Marshall
12 Magruder from Tubac, Arizona, and I am intervening as a
13 ratepayer. Let me tell you why I'm here, three reasons:
14 My personal experiences with takeovers, UniSource
15 management concerns, and the charity issue.

16 First, I've experienced significant changes
17 in ownership in my career. The first 25 years were in
18 the military which has its unique culture and mono-, and
19 monopolistic business practices. In those days, it was
20 not the ideal model of efficiency, but where I learned
21 over and over again how to do more with less through
22 aggressive conservation and efficient practices, which
23 is one reason the comments from Mr. Robertson concerning
24 renewable energy and efficiency are things that we
25 should stress in all of our dealings.

1 I then went on to work for a non-profit
2 company, Hughes Aircraft Company, owned by the Howard
3 Hughes Medical Foundation, the largest private
4 foundation in the world, with emphasis on basic research
5 which has no profit on things such as AIDS long before
6 the government got involved. During that time, profit
7 was not our motive, but the business culture was always
8 there to solve the problem. In particular, the harder
9 the problem, the harder we worked, as with LASER, the
10 digital watch, satellite communications, are just some
11 of our inventions. This non-profit privately-owned
12 company's culture was extremely creative as the largest
13 company in California with 83,000 employees.

14 We were then sold to General Motors, I guess
15 considered another large company, who transformed us to
16 a company who had to earn a profit in a benevolent
17 manner. General Motors brought in a controller which is
18 a very logical position because they owned the company.
19 But otherwise, our company's culture shifted to new
20 goals for both solving the problem and earning a profit.
21 We had about 1,500 projects at a time, each really a
22 separate entity, almost like a separate company, but
23 some lost money, and some earned money. The important
24 thing was that we were always positive.

25 General Motors looked at our management,

1 they trimmed a layer from five layers to four layers
2 between the employee and the President of the company.
3 We worked to a quarterly profit schedule which we found
4 out negatively impacts creativity and innovation because
5 there are many false starts in that environment. But
6 this profit transformation was not very difficult or
7 painful because it gave us another challenge, and to a
8 culture that likes challenges.

9 When General Motors sold us to another
10 northeastern company, we were told it would be just like
11 the previous sale, that the management would stay, that
12 everything would be carried on the same, that there
13 would be the same benefits, no layoffs or plant
14 shutdowns, and our business practices that we had used
15 over the years would stay.

16 Well, first, this new management team
17 changed many people by changing the upper management
18 people. Internal communications was nearly eliminated,
19 and many very negative financial decisions were
20 repeatedly exercised. All communications had to go
21 through a remote three-time-zone-away company
22 headquarters that just didn't care. Our Hughes Company
23 newspaper's last issue was, and the last time we had a
24 paper for several years, was the day the merger was
25 completed. One day I saw 300 people leave, each with

1 over 30 years of service, because younger people earn
2 less and are cheaper. There was no concern about our
3 corporate knowledge or unique skills, but younger people
4 earn less.

5 The inter-company shuttle and mail service
6 was stopped. Retirement health benefits eliminated. In
7 fact, the retirement plan was cancelled for all the new
8 hires, and those onboard, and then they added five years
9 before you could retire. Medical benefits were
10 stripped, and the company nurse laid off, in addition to
11 25,000 other employees over a three- or four-year
12 period. I went through six building shutdowns where I'm
13 almost the guy that has to turn the light out as we
14 moved from one site to a new site. Morale plummeted.
15 Many excellent employees just left. Our experience
16 level was lowered. Pay raises were less frequent, 13-
17 and 15-month schedules instead of annually, if at all.
18 Lots of times we didn't get a pay raise, but the pay
19 raise average was always lower than inflation.

20 Traditional programs like advanced employee
21 education were eliminated. The company training was
22 done as a voluntary brown bag lunch by dedicated
23 employees who knew that their contemporaries needed to
24 learn new tricks and new ways to do the job. They were
25 dedicated because they did it during lunch hour, not

1 with company sponsorship.

2 My office sank to a six foot by six foot
3 cubicle that I had to share with another employee. That
4 saved a lot of money. This is what happens when real
5 cost cutters come to the scene with a different business
6 model and culture. But the important thing about a
7 company's culture is it stays for the life of a company.
8 How will Saguaro's ownership with a different culture be
9 more successful than with that that is now at UniSource.

10 I'm a ratepayer at UES, an independent pair
11 of public service companies. In these proceedings, we
12 keep hearing about TEP. It was the prime context of
13 what Mr. Heyman's article, which is, presentation which
14 is a different UniSource public service company which
15 has high debts and could possibly increase higher. But
16 now how will the better -- let me start over again. How
17 will the better financial status and income performance
18 of UES be impacted with lower bond ratings shifting from
19 TEP to UniSource? This puts the most profitable part
20 of UniSource, which is UES, into a potentially negative
21 financial situation. From a UES view, why is this a
22 good deal? Is it really worth it?

23 From the financial numbers in the testimony,
24 there appears to be little option for UniSource's new
25 buyers to make money without some kind of significant

1 financial shakeups. Here's some options: Cut personnel
2 costs; increase revenues with higher rates; decrease
3 general administrative costs, which is really executive
4 salaries; decrease contributions; sell off companies or
5 parts; lower interest rates. Looking at personnel
6 costs, you can save them through layoffs, lowering
7 salaries, deferring benefits, early retirements,
8 lowering benefits across the board from medical to
9 tuition assistance, but layoffs and outsourcing are
10 generally the most likely options for most new owners.
11 I've been through this. This hurts the company mostly,
12 and also the ratepayers because they will receive lower
13 quality of service. We saw significant layoffs in
14 Nogales during the transformation from Citizens to
15 UniSource.

16 On increasing customer rates, we've had a
17 significant raise. How can they make money just by
18 increasing rates which have to be significant because
19 fuel costs are not a factor in those determinations?

20 Friday's newspaper indicated that TEP's
21 requested a 16 percent increase in its general rate case
22 submitted several days ago. UES has recently raised
23 both electric and natural gas rates over 20 percent, but
24 again, not to be increased until 2007 or 8. Reducing
25 general administrative costs is very unlikely because

1 the present set of executives and directors are
2 delighted with the \$34 million package they will receive
3 when this deal is consummated; Mr. Pignatelli'
4 6.6 million, Mr. Glaser's 1.8 million, Mr. Nelson's
5 1.2 million, and all the others equal to about \$60 per
6 ratepayer. Is that what the ratepayers want, because
7 that's where the money comes from.

8 Retaining contributions in the charity
9 program, reducing it from shareholders to the charities,
10 will be a challenge. Where will the shareholders be for
11 the contributions in the future organization? Why
12 should venture capitalists support these kinds of
13 non-financially beneficial activities as an investment?
14 Splitting up and selling companies is likely in my view.
15 UES, the former Citizens or Citizens Communications was
16 sold to Caprock, and then that sale got cancelled, then
17 it was sold to UniSource, all in the past few years.

18 After years as a disposable asset, such
19 activities do not help a company's culture or improve
20 morale. Thus, when a company is up for sale, only
21 short-term cosmetic changes are funded. Personnel costs
22 are usually reduced by not hiring, and long-term capital
23 improvements grind to a halt. For an industry with a
24 minimum of 20 and usually a 50-year capital investment
25 view, this may cause failure. Utilities, electric

1 utilities cannot fail. The new owners may lower
2 interest rates, which is hard because the rates are
3 rising now in the general trend. However, this makes it
4 the larger loans just have more interest, which is what
5 is going to happen in this result.

6 I see no change, no chance to improve our
7 utility's infrastructure, increased maintenance, or have
8 adequate personnel levels which is the glue in the
9 organization. I've been through rape, plunder, and
10 pillage. The results devastate a company's culture, its
11 morale, its infrastructure, and usually financial
12 results for the purchased company become a disaster.
13 The promises are not always kept.

14 I'm concerned about this management team.
15 Mr. Pignatelli has been involved with actions to sell
16 this company since 1999, for the past five years. Has
17 that influenced all of his decisions? You bet it has.
18 He started serious discussions with this set of
19 investors three years ago, I believe long before he
20 started to purchase Citizens. He stopped during that
21 set of acquisition steps, and then moved into a deal
22 that we're discussing today. How many times has this
23 company come before this Commission in the past three to
24 five years with issues that today's discussions could
25 impact? When one is in his position, he holds all the

1 cards, and controls and manipulates in accordance with
2 the company's business plan.

3 A good, the good faith rate negotiations
4 with Pinnacle West failed and were reported on 2 March
5 of this year. An RFP had been issued to over 30
6 potential bidders who knew they had to beat a wholesale
7 rate of 58.79 a megawatt hour. Ten submitted bids. No
8 one ever submits a bid that won't win. You don't waste
9 your time or money on that effort. Thus, all ten should
10 have been below the present market. How could that
11 fail? I offer several reasons.

12 The day I received the letter from, who did
13 I receive it from, UniSource, on 2 March which included
14 a faulty, which I concluded that either a faulty or
15 poorly constructed RFP, a convoluted evaluation process,
16 a poor understanding of the issue, which had to be
17 doubtful, and several other probable reasons, UniSource
18 and Pinnacle West in my view did not want it to succeed.
19 Why? I think there's something going on behind the
20 scenes, which is very common in this industry, but it's
21 also very hard for an individual ratepayer to find an
22 and uncover. Of course, the RFP was confidential and
23 redacted copies were received with the reports. To add
24 insult to this process, UniSource recently sent out a
25 letter last month with the present natural gas price

1 curves. Yes, they're high, but the DOE EIA has stated
2 this is not due to shortages due to OPEC, because
3 99 percent of our natural gas is already in the United
4 States.

5 We have three major sources of fuel in
6 Arizona. We have the nation's largest nuclear
7 generation plant which produces electricity for about
8 \$30 a megawatt. We have coal-generated electricity
9 which accounts for 95 percent of Tucson Electric's
10 customers, and we have natural gas used elsewhere for
11 different operations. The emphasis in this RFP appeared
12 to be on natural gas which might have been the fault,
13 but I don't know. During this time, a few months
14 earlier, the City of Nogales had three bids in the \$40
15 range. Something is fishy here. I intend to
16 cross-examine on this issue to show that management
17 isn't perfect at UniSource. That failure to consummate
18 agreement was management related.

19 Also the company made several questionable
20 investigations. For example, the Salinas investment is
21 a coal mine in an 800 megawatt power plant in Mexico.
22 Mr. Pignatelli is on the board of directors. Why is
23 UniSource doing this? Why and when is it going to be
24 profitable? This power plant is a CFE, which is the
25 initials of a Mexican electricity monopoly. When is

1 it -- they own the power plant. A recent Mexican
2 Chamber of Commerce found that 98 percent of all public
3 works contracts in Mexico involve mordita, as they were
4 unable to determine that they had a conspiracy existed
5 in the other 2 percent. Could this be TEP's dues to
6 Mexico for their transmission line?

7 Another subject, charities, there are at
8 least 60 more letters in this docket from large and
9 small charities and various government agencies
10 generally supporting this acquisition. They were once
11 told, they were only told a little about UniSource plans
12 and asked to write letters. Many of them carbon copied
13 the same person at UniSource. I will explore this a
14 little more under cross-examination, but from their
15 tone, all UniSource management and employees appears to
16 do is to work with such organizations. They have other
17 things, I think, to do than just to be a charity.
18 Education about electricity, safety, conservation, and
19 efficient training by the company is a public service
20 company mission which actually has I believe the support
21 of everyone.

22 Who makes the decisions to support which
23 charity? What about charities that are focused towards
24 politicians? We have several of those related in our
25 county. Friday's Nogales International disclosed that

1 the attorney general's office in the state is
2 investigating the use of \$6,000 in city's funds to
3 support either TEP or PNM's transmission line proposal.
4 It wasn't clear which one.

5 Another issue is that a county supervisor
6 last Wednesday in public comments thanked UniSource for
7 donating electric lights at the new county park. But he
8 didn't continue on to say that the park is named after
9 him, and he's up for reelection, and it's not going to
10 be an easy election. And another supervisor with low
11 income loans for the elderly discussed how nicely the
12 company handled those loans. He didn't continue to say
13 that he managed those low income homes as his primary
14 job. Are these charity donations, or are they
15 requesting political favors?

16 Also, I intend to talk about political
17 action campaign donations at both the state and local
18 levels. In addition, Citizens double charged the City
19 of Nogales and the county since about 1975 for the same
20 street light's electricity. The county was out over
21 \$100,000. This overcharge, did this overcharge get
22 returned to the general fund? No. Citizens provided
23 the \$100,000 about six weeks before the
24 Citizens-UniSource ACC hearing, so that the UES chief
25 operating officer could hand out checks to over 25 local

1 charities in the county Board of Supervisors' chambers,
2 an absolutely superb public relations trick at the
3 expense of the county administration that is still
4 suffering from the six layoffs it had to make from that
5 year.

6 But why does this electric company operator
7 want the public to perceive that it's a charity? It is
8 for management's own personal gain, not for the role as
9 a public service provider. There are no checks and
10 balances on these contributions. In fact, why should
11 any public service company choose where they want to
12 give my money to? I want to decide which charities
13 receive my money. Can anyone guess why Mr. Pignatelli's
14 name was on the old Fox Theater's marquee a few weeks
15 ago? Four of the top five UniSource officers are
16 attorneys, including one that had previously served on
17 the ACC Staff. Mr. Heyman and I usually joke about how
18 lawyers weasel word documents, but in all seriousness, I
19 would recommend you consider reviewing all of the
20 UniSource and its affiliate actions before this
21 Commission for at least the last three years to
22 determine how, if any, UniSource could have manipulated
23 various proceedings leading up to this buyout and greedy
24 financial rewards to its top management and board of
25 directors when this deal closes. I will ask about

1 possible, some possible manipulations during
2 cross-examination.

3 I feel that unless these proceedings
4 indicate that there are any benefits to ratepayers and
5 customers, and no risk, then the only logical outcome of
6 these proceedings would be to deny the application. In
7 fact, I'm very pleased with UES as my electric and gas
8 provider. Although as a footnote, and something that
9 was mentioned during public comments last week, a
10 condition to move this lethargic company towards
11 renewable energy, demand side management, distributed
12 generation, and the modern electric processes and
13 procedures that the people want, we will continue in a
14 centralized controlled electric company.

15 Thank you very much.

16 ALJ RODDA: Okay, thank you, Mr. Magruder.
17 Mr. Pozefsky.

18 MR. POZEFSKY: Thank you.

19 Good afternoon, Commissioners Mayes,
20 Mundell, Gleason, Your Honor.

21 I would just like to take an opportunity to
22 say that we'll be here -- I'm Dan Pozefsky again from
23 the Residential Utility Consumer Office. With me here
24 today is Marylee Diaz Cortez who is going to be our
25 witness as well as Stephen Ahearn who is the RUCO

1 director.

2 This proposed merger really impresses upon
3 the Commission the need to protect the public interest.
4 While on its face there are some benefits and appealing
5 aspects, beneath the surface as we will show, the
6 proposal places ratepayers at an unacceptable level of
7 risk.

8 For example, the company touts cash infusion
9 into the regulated entity, TEP, and how the monies will
10 be used to pay off its inter-company debt. This argues
11 the company will improve TEP's debt equity ratio to
12 40-60 percent which will meet the ratio that the
13 Commission had already targeted for December 31, 2000.
14 The impression is, of course, that now we will have a
15 less leveraged TEP and a better capital structure.
16 True, there is a benefit to a better capital structure,
17 but do not be mistaken: It comes at a cost.

18 TEP's unregulated holding company,
19 UniSource, now becomes more debt leveraged post-merger,
20 and UniSource does not generate its own income.
21 UniSource depends on TEP for the majority of its income,
22 so if TEP comes up short, UniSource comes up short. The
23 arm is attached to the body. Moreover, monies that TEP
24 would have used to pay down debt or for other investment
25 will now be paid in the form of dividends to UniSource's

1 shareholders, again putting pressure on TEP to generate
2 income.

3 The company touts as a benefit that
4 management will not change. That is a good thing.
5 However, while the people may not change, the personal
6 positions will. Of course, as you will hear, we do not
7 know to what extent, but obviously, their equity
8 positions will change. There are no employment
9 contracts as of yet that we're aware of, and the changes
10 in control positions that will be in place post-merger,
11 those protect the employees, not the company. Once
12 management relinquishes its equity positions, what
13 incentives will they have to work and prosper under
14 someone else? What makes this more risky is that the
15 investors do not have a background in this business and
16 are dependent upon current management to be successful.
17 We will show even more examples of what the company sees
18 as benefits as really being risks.

19 I am not saying that there are no benefits
20 to the proposal, but what I am saying is that there are
21 no incremental benefits to justify the additional risks
22 these out-of-state investors have no utility background.
23 They want to buy this utility, leverage the holding
24 company, diversify their portfolio, establish some
25 equity, and then sell the company at a profit. In

1 short, it is an investment which they hope will
2 eventually turn a profit. They want to do it under the
3 guise that they will improve the status quo. Status
4 quo, however, TEP is doing fine.

5 TEP is moving towards the 40-60 debt to
6 equity ratio and should achieve it based upon our
7 calculations by 2007. UniSource is doing well
8 financially and does not need to weaken its financial
9 condition by taking additional leverage and additional
10 risk which goes along with this merger. In the absence
11 of the merger, TEP's management will continue to run the
12 business with great incentive given their equity
13 positions. TEP is not in a financial predicament, and
14 there is no reason why TEP will not be able to continue
15 to strengthen its financial position over the next
16 several years. Why then should TEP take on the
17 additional risks when there really is no incremental
18 benefit? The Commission should not subject TEP's
19 ratepayers to additional and unacceptable risks by
20 approving this merger.

21 Thank you.

22 ALJ RODDA: Thank you, Mr. Pozefsky.

23 Mr. Kempley. I didn't forget you this time.

24 MR. KEMPLEY: No.

25 Thank you, Your Honor. Good afternoon.

1 Good afternoon, Commissioner Mayes, Commissioner
2 Mundell, Commissioner Gleason.

3 It's frequently the case that the Commission
4 Staff finds itself in the middle on proceedings. The
5 Staff's role in our view is somewhat parallel to the
6 role that the Commission has in analyzing these
7 proceedings. We represent as best we're able the public
8 interest.

9 This proceeding presents a situation in
10 which a unique transaction is proposed. Commissioner
11 Mundell referred to it as a case of first impression, as
12 Mr. Heyman noted. We believe it is a case of first
13 impression in Arizona. We believe that it is generally
14 a matter in which there is, while some, very little
15 guidance pointed to the Commission to help resolve how
16 to decide whether or not to approve this leveraged
17 buyout of a utility.

18 Any utility merger requires strict scrutiny
19 from the Commission, and you've heard considerable
20 discussion today of the situations in which those
21 matters have been presented to the Commission, this one
22 perhaps more than others, and one reason for that in our
23 view is what I would call the concentration of power to
24 affect utility operations.

25 One of the documents that's attached, the

1 last document that is attached to the packet that
2 Mr. Heyman had passed out at the beginning of the
3 proceeding is a description representing who will have
4 invested and what the corporate organization would look
5 like post-merger. It's very interesting to see when you
6 look at that representative chart the focus of power in
7 the Saguaro Utility Group, an entity which doesn't exist
8 today. The description by UniSource has been a transfer
9 of one group of institutional investors for another
10 group of institutional investors, and to some extent,
11 that's a true description, but it's the concentration
12 within a small core that we believe amounts to a
13 substantial change in the character of ownership of
14 UniSource, assuming this transaction to be approved.

15 It's also of interest and has been noted
16 that this is not a utility to utility merger as all of
17 the previous merger proceedings of which I'm aware that
18 have been presented to the Commission have been. As a
19 result, there are no synergies or economies of scale
20 that necessarily are available to provide operational
21 efficiencies, and yet there's an approximate 30 percent
22 premium to shareholders being offered under this
23 arrangement.

24 I just want to digress for a moment at this
25 point, and talk a little bit about the standard of

1 review. Mr. Heyman emphasizes the Commission's
2 Affiliated Interest Rules, declares that there's no
3 conflict, that that specifies the standard, and I just
4 wanted to point out that the Staff has a somewhat
5 broader view of the standard to be applied in this case
6 than the narrow view espoused by Mr. Heyman.
7 Mr. Robertson kind of alluded to it by his indication
8 that he thought that the Affiliated Interest Rule bore
9 in all fairness reading into it a public interest
10 standard. We don't think you need to read that into the
11 affiliated interest rule. Instead, what we think you
12 need to do is to consider this proceeding in a broader
13 context.

14 The Affiliated Interest Rule does in fact
15 specify some conditions in which the Commission may
16 reject mergers of public service corporations, but
17 starting with the Constitution, and examining the
18 statutes and examining the case law that has been
19 derived over the years, what you find in Staff's view is
20 that the Commission has an obligation that I would
21 characterize as pervasively regulating the public
22 service corporations and pervasively regulating public
23 service corporations in the public interest, and
24 specifically, to the protection of customers.

25 The legal standard will be expanded upon.

1 We anticipate that this proceeding will involve some
2 briefing, and it would be my view that the
3 representation of how the proposed conditions comport
4 with the legal standard and the parties' positions with
5 respect to whether the public interest is in fact served
6 by approval of this transaction is best derived by
7 hearing the testimony, reading the briefs, and examining
8 the overall positions at that point.

9 Now, to return back to the transaction and
10 what the issues are that are presented, you remember I
11 was commenting that we had a situation with no
12 particular necessary synergies. I think Mr. Meek called
13 it one that isn't intuitively sensible to us, and yet
14 there's a 30 percent premium to shareholders, and then
15 the question becomes how do the investors have an
16 opportunity to make this transaction pay off.

17 Other parties have kind of gone through
18 these, but I only see about three ways that can happen.
19 One happens as a result of the increased leverage of the
20 consolidated organization. When you increase the debt
21 level and get equity returns on it, the result is a
22 slight increase to the incomes. The second way is by
23 cost cutting at the utility, although we certainly have
24 promises that that's not the intent, and there's a
25 number of conditions that are proposed which in Staff's

1 view minimizes the likelihood of substantial cost
2 cutting becoming a problem. And the third I would
3 characterize as holding the entity for possible
4 appreciation as the consolidated entity and the utility
5 in particular becomes stronger. That seems to me to be
6 the most likely avenue for these investors to achieve a
7 return on their investment from buying this utility.

8 From the Staff's perspective, what this
9 transaction presents is a number of risks, potential
10 risks to ratepayers with little guarantees of reward.
11 There are risks of harm to the manner of operating the
12 system, and the reward appears to be the improved credit
13 reliability over what TEP and UniSource have experienced
14 in the past. Staff's response to that set of
15 circumstances has been to examine ways to mitigate the
16 risks, to mitigate those increases to risks as risks
17 always exist in the operation of the utility.

18 We've proposed a series of conditions across
19 six broad areas: Utility financial segregation and
20 protection, service quality and assurance of
21 reliability; affiliate transactions and costs; corporate
22 governance; regulatory oversight and access to records;
23 and community presence. Each of these areas presents an
24 arena in which the nature of this transaction raises
25 issues of possibly increasing risk. All of those arenas

1 are not created equal, but they must all be addressed in
2 a satisfactory manner before Staff is in a position to
3 say that the increased risk from this transaction has
4 been controlled sufficiently to justify approval.

5 I don't want to go through all of Staff's
6 testimony or the company's response. Suffice it to say,
7 we agree with Mr. Heyman that in large measure, the
8 concerns raised by Staff and our proposed conditions
9 have been met by Mr. Pignatelli's surrebuttal and
10 additional matters that we expect to be adopted from the
11 stand.

12 However, from looking at Mr. Antonuk's
13 surrebuttal testimony, it's clear that there remains a
14 gap to close. Mr. Antonuk proposes additional
15 clarifying conditions designed to accomplish Staff's
16 objectives.

17 First, Mr. Antonuk proposes conditions
18 designed to maximize the likelihood that the enhanced
19 equity levels that will be achieved upon completion of
20 this transaction will be in fact maintained.

21 Second, Mr. Antonuk proposes a condition
22 designed to maximize the protection of the utility from
23 the dangers of bankruptcy of the parent or other
24 affiliates, and from pressures from the creditors of
25 those affiliates.

1 Third, Mr. Antonuk proposes clarification of
2 the conditions relating to possible non-utility
3 investments by UniSource, Saguaro, and Saguaro Holding.

4 Fourth, Staff continues to believe as
5 evidenced in Mr. Antonuk's surrebuttal testimony that
6 retaining the possibility of an outside audit of
7 management and performance is a tool the Commission
8 should have at its disposal to protect customers.

9 Fifth, Staff believes that the change in
10 ownership and the corporate structure warrants a
11 reexamination and a requirement that any waivers of the
12 Commission's Affiliated Interest Rules be justified anew
13 under the new corporate structure as well as a revised
14 code of conduct to reflect the new situation.

15 And finally, Staff proposes somewhat more
16 stringent conditions for requiring Commission approval
17 of ownership changes than were proposed by the
18 applicants.

19 In conclusion, consideration of a merger
20 transaction always involves determining whether that
21 transaction is in the public interest, whether we refer
22 to a No-Harm Rule or the broader examination that the
23 Staff and some of the other parties believe.
24 Ultimately, the conclusion the Commission has to make is
25 whether approval of the transaction is in the public

1 interest.

2 Virtually any utility merger results in some
3 additional risks to customers, and this one is certainly
4 no exception. The Commission's job and the analysis
5 that Staff has undertaken is to minimize those an
6 additional risks and to balance them against any
7 potential benefits from the transaction.

8 In this case, Staff has gone to considerable
9 effort to propose conditions designed to protect the
10 utility and its customers from the increased risks.
11 With Staff's proposed conditions in place, we believe
12 those additional risks will be minimal. There is very
13 little in the way of benefits to the utility and its
14 customers to weigh against those risks. While
15 shareholders will see substantial immediate benefits,
16 the utility and its customers must await the results of
17 operations over several years, and the benefit will
18 primarily be in the form of a financially healthy
19 utility, something that we all might have hoped for
20 without this transaction. In these circumstances, the
21 Staff finds itself in the position of being neutral with
22 regard to the transaction.

23 One final note that I want to make,
24 Commissioner Mundell's letter raises a number of
25 questions surrounding the interaction of the company's

1 rate case filing with this proceeding. The rate case
2 filing has been an expected event with known risks to
3 the company for some time. Presumably, the investors
4 understood this -- presumably, the investors entered
5 into this transaction knowing that the filing would be
6 made and that revenues could decline under that filing
7 but not increase.

8 Staff believes as we indicated in our
9 response to the Commissioner's letter that it is
10 premature at this point to reach any conclusion on the
11 over-earning issue, nor do we believe that this
12 proceeding should be delayed while that decision is
13 reached. However, all parties should be aware of the
14 possibilities presented by that case. If this
15 transaction is approved, it should be and will be with
16 the awareness of the investors that current revenues are
17 not assured.

18 Thank you.

19 ALJ RODDA: All right. Thank you,
20 Mr. Kempsey.

21 I'll note for the record that Mr. White
22 representing Mohave County indicated earlier that he
23 didn't have an opening statement this morning, or this
24 afternoon now.

25 With that, we will break for lunch until

1 2:00, and resume with Mr. Pignatelli on the stand.

2 Thank you.

3 (A recess ensued.)

4 (Dawna J. Boswell, Certified Court Reporter,
5 was excused from the proceedings.)

6 (TIME 12:44 p.m.)

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 (The proceedings were resumed at 2:04 p.m.
2 with Annette Satterlee, Certified Court Reporter,
3 acting as official court reporter.)

4 ALJ RODDA: Let's go back on the record.

5 I wanted to, before we start with
6 Mr. Pignatelli, I wanted to raise an issue that came
7 to my attention at the break, and that is it's my
8 understanding that the Commissioners may have
9 questions concerning some confidential documents that
10 were provided on Friday.

11 So my question to the company in
12 particular, and Staff or any other interested party,
13 is how we should handle questions concerning those
14 docs. My understanding, they are minutes of board
15 meetings or committee meetings.

16 MR. HEYMAN: Your Honor, this is Ray
17 Heyman on behalf of UniSource Energy Corporation.

18 If what we are referring to is a reference
19 that RUCO made in their response to Commissioner
20 Mundell's questions, which had an excerpt of a
21 statement made by Mr. Pignatelli -- is that what we
22 are talking about?

23 ALJ RODDA: I'm not even sure.

24 COM. MAYES: Actually, my questions were
25 much broader than that. I've already written down

1 about 20 questions that are derived from the
2 confidential materials that were provided as a result
3 of Commissioner Mundell's letter and the material that
4 came in, I think late on Friday.

5 MR. HEYMAN: I can tell you what we have
6 done in the past pursuant to the protective agreement,
7 and maybe Staff can help out as well. But, generally,
8 we have done that in camera and had that portion of
9 the transcript sealed because of the confidentiality
10 of it and the fact that it was pursuant to a
11 protective agreement.

12 ALJ RODDA: Well, here --

13 MR. HEYMAN: Let me just add this, Your
14 Honor, that I guess it's kind of hard to know without
15 knowing -- and I'm not asking for the questions ahead
16 of time, but some of the information may have been
17 published elsewhere that week. If that comes up and
18 we can waive it or point out that it is okay to
19 answer, we certainly would do that as well.

20 ALJ RODDA: Whenever we have confidential
21 documents or -- it's been my experience that documents
22 are often filed at the Commission kind of blanket,
23 these are confidential, and we don't always, at least
24 as the Administrative Law Judge, it's not always
25 brought before me to determine their actual

1 confidentiality. And if everyone is in agreement,
2 usually we muddle through somehow. But if there
3 becomes an issue on certain information, we may have
4 to have a separate proceeding to determine if it is
5 confidential or not.

6 MR. HEYMAN: We certainly want to make it
7 as easy as possible. And maybe if Commissioner Mayes
8 has some questions and they are of the nature that we
9 can comment on them and say that, yes, these were
10 provided confidentially, or the answer would be, but
11 because of the circumstances we can waive that, maybe
12 we can address it on a question by question basis.
13 That's kind of tedious, but --

14 MR. KEMPLEY: Your Honor, if I may weigh
15 in briefly here.

16 In the past, the procedure that I think
17 Ray outlined allows the questioning to take place
18 without having to reach the question of whether the
19 information is actually protected by law. It's kind
20 of an extension of the protective agreement. If you
21 let questions take place on an in camera basis, you'd
22 obviously have to turn off the webcast, and then the
23 only time that I think you reach the issue of whether
24 the information is actually protected or not is if
25 there is some need either based on the Commissioners'

1 perspective or your perspective in drafting an order
2 that that information become in the public domain.
3 And then you would, of course, reach the question of
4 whether you had an obligation to protect it.

5 But we've typically tried to keep the
6 proceeding moving in a manner in which the
7 Commissioners -- I assume all parties are signatories
8 to a protective agreement.

9 MR. HEYMAN: No. Not all of them are.

10 MR. KEMPLEY: Well, that presents a bit
11 of a complexity. Typically, it's been the case when I
12 have been involved that all the parties were parties
13 to a protective agreement. I guess you get to the
14 point where the company will ultimately, potentially
15 be put to the test whether it really wants to claim
16 the information is protected or not, and then we may
17 have your additional proceedings.

18 COM. MAYES: Your Honor, Mr. Heyman, was
19 it the intention of the companies and the investors
20 that the Strategic Advisory Committee minutes be
21 confidential?

22 MR. HEYMAN: It was, and they were
23 provided pursuant to the protective agreement. There
24 are portions of that, though, that we might be willing
25 to waive the confidentiality on.

1 COM. MUNDELL: And just the same question
2 on the minutes of the board, special board meetings.
3 Are those confidential, also? We have this big packet
4 here of confidential material that --

5 MR. HEYMAN: Right. Yes, those were.
6 And the same thing, that the general position is that
7 those are confidential and when we provide them to
8 third parties, outside parties, we provide them on
9 confidentiality. If a subject matter that's addressed
10 in there is something that has been made public
11 otherwise, we would obviously, in the context of this,
12 ask that we be allowed to waive it limited to the
13 subject matter.

14 It might make more sense from what I'm
15 hearing, when we get to the Commissioners, to do it
16 and have the questions asked, and we can kind of play
17 it by ear then.

18 COM. MUNDELL: And just to that point --

19 COM. MAYES: Quickly, the problem is,
20 though, is I'm going to ask questions specifically
21 about statements that were made at these meetings and
22 that are included in these minutes. So, Ray, the
23 problem is if I ask the question that could
24 potentially divulge information that you would
25 consider confidential. So I'm kind of in a quandary

1 here.

2 MR. HEYMAN: Let me suggest this: Would
3 it be possible to know which minutes you're talking
4 about, without specific questions, and then we can go
5 have the company look at it and say --

6 COM. MAYES: Well, just for starters
7 is -- I haven't gotten through the whole thing.

8 MR. HEYMAN: I understand.

9 COM. MAYES: But I can tell you I have,
10 you know, questions about minutes from November 4th,
11 2003, specifically page 15; page seven of November
12 4th, 2003; page six of November 18th, 2003; page nine
13 of November 18th, 2003; page ten of November 18th,
14 2003; page 18 of, I think it was November 4th, 2003.

15 MR. HEYMAN: Okay.

16 COM. MAYES: That's just the beginning.
17 There's probably more.

18 COM. MUNDELL: And I probably have a
19 question from each one of the different minutes from
20 different meetings that you provided us. I mean, I'm
21 starting to go through them, different dates, but I --
22 I've got them tabbed, and I guess I would be surprised
23 if none of the parties have any questions, also. You
24 said the Commissioners, but all this information as I
25 understand it was provided to our Staff and RUCO and

1 everyone else. So maybe I'm wrong, but I would think
2 there would be some questions they would want to pose,
3 also, from these minutes. But they can certainly run
4 their case the way they see fit.

5 MR. HEYMAN: Commissioner Mundell,
6 obviously, if we are going to waive it for the
7 Commissioners, we waive it for the other parties as
8 well. This is helpful, and maybe this is a good thing
9 for me while we are continuing on with Mr. Pignatelli
10 to have somebody else look and see if this causes any
11 problems and we will let you know at the first break
12 if we are going to go ahead and waive it or if we have
13 particular concerns that we need to address.

14 Our tendency would be to try and have a
15 free flow of information on this, so that's why I
16 would at least like to be able to look at it before we
17 proceed along these lines.

18 COM. MUNDELL: Just so I'm clear -- and
19 maybe, Judge, you could have other people answer this.

20 Is the material that I requested in my
21 letter, had anybody else reviewed that under the
22 confidentiality agreement? The Staff, RUCO, any of
23 the Intervenors?

24 MR. HEYMAN: I don't know who reviewed
25 it, but I can tell you who we provided it to. If you,

1 for example, Commissioner Mundell, asked us some
2 questions, we provided our responses to all the
3 Commissioners and to all of the parties who had signed
4 confidentiality agreements if there was confidential
5 information in there.

6 COM. MUNDELL: That's not my question.
7 My question is prior to my letter being sent out ten
8 days ago, had anybody requested this information prior
9 to my letter being sent out?

10 MR. HEYMAN: Yes. A lot of the
11 information you requested, a lot of the documents we
12 provided to you, we had already provided to the
13 parties that had signed confidentiality agreements. I
14 know for example on the last question that you had, I
15 think all those documents had been provided to staff
16 and RUCO.

17 COM. MAYES: Were all of the minutes of
18 all of the Strategic Transaction Advisory meetings
19 provided to both staff and RUCO?

20 MR. HEYMAN: I believe they were, yes.
21 And it was under a protective agreement.

22 COM. MAYES: It was.

23 MR. HEYMAN: Yes.

24 COM. MAYES: Your Honor, I will abide by
25 your desire to go forward with the questioning of the

1 panel of folks that are being brought in from Morgan
2 Stanley and the other investors, but I do, based on
3 the minutes, I can foresee the possibility of asking
4 that additional witnesses be brought here for
5 questioning, individuals who were in these meetings,
6 because it's my understanding that the individuals who
7 were -- some of these individuals who were in the
8 meetings representing the investors are not the ones
9 that are coming here this week to represent the
10 investors.

11 So I will hold off on making that request,
12 but I just, so everyone is on notice, I can foresee
13 asking that those people be brought here for
14 questioning.

15 ALJ RODDA: Okay.

16 MR. HEYMAN: Just so that it's clear what
17 I have committed to do is I will have somebody look at
18 these dates -- and I understand Commissioner Mundell
19 may also be looking at some other documents as well --
20 and see where we are as far as the information that's
21 contained on these pages and these documents, if we
22 can go ahead and waive them or if we still need to
23 discuss it a little bit more.

24 ALJ RODDA: Okay.

25 MR. HEYMAN: Thank you.

1 ALJ RODDA: So we will know more at the
2 end of the day, perhaps?

3 MR. HEYMAN: Hopefully during a break, if
4 we have one in the afternoon, we will try and get that
5 information to you.

6 ALJ RODDA: Thank you, Mr. Heyman.

7 With that, I will ask Mr. Pignatelli to
8 come down and be sworn.

9 MR. HEYMAN: Your Honor, if I might, I
10 would like to give Mr. Pignatelli copies of the
11 exhibits we will be talking about.

12 ALJ RODDA: Yes, please.

13

14 JAMES S. PIGNATELLI,
15 called as a witness on behalf of the Applicant, having
16 been first duly sworn by the Certified Court Reporter,
17 was examined and testified as follows:

18

19 DIRECT EXAMINATION

20

21 Q. (BY MR. HEYMAN) Mr. Pignatelli, would you
22 please state your name for the record.

23 A. James S. Pignatelli, P-i-g-n-a-t-e-l-l-i.

24 Q. By whom are you employed and in what
25 capacity?

1 A. I'm employed by UniSource Energy and
2 Tucson Electric Power as the chief executive officer,
3 president, and chairman of the board of each of those
4 companies.

5 Q. Mr. Pignatelli, have you filed in this
6 proceeding direct testimony, rebuttal testimony, and
7 also a witness summary?

8 A. Yes, I have.

9 Q. Do you have in front of you what's been
10 marked for identification as Exhibit A-1, which is a
11 notice of filing and the direct testimony of James S.
12 Pignatelli, dated February 12th, 2004?

13 A. Yes. I have that before me.

14 Q. Was Exhibit A-1 prepared by you or at your
15 direction and supervision?

16 A. It was.

17 Q. And do you have any changes to make to
18 this testimony at this time?

19 A. No, I do not.

20 Q. Do you adopt the testimony, what's
21 contained in Exhibit A-1, as your sworn --

22 A. Yes.

23 Q. -- direct testimony in this proceeding?

24 A. Yes, I do.

25 Q. Now, do you have in front of you what's

1 been marked as Exhibit A-2, which is the rebuttal
2 testimony of James S. Pignatelli, dated May 25th,
3 2004?

4 A. Yes, I do.

5 Q. And was that similarly prepared by you
6 under your direction or supervision?

7 A. Yes, it was.

8 Q. And do you adopt the testimony in Exhibit
9 A-2 as your sworn rebuttal testimony in this
10 proceeding?

11 A. Yes, I do.

12 Q. Now if would you turn to the document
13 that's marked Exhibit A-3. Do you have that?

14 A. Yes, I have it.

15 Q. And this is a notice of filing summaries
16 of both you and Mr. Scott Stuart, but attached to it
17 is just the summary of your testimony together with
18 two tabs. Is that correct?

19 A. That's correct.

20 Q. And what is attached to Exhibit A-3 is an
21 accurate summary of your testimony? Is that correct?

22 A. Yes, it is.

23 Q. And exhibit one to that is a Red-lined
24 Version of Modifications to Proposed Conditions?

25 A. Yes, it is.

1 Q. And tab two to that witness summary is a
2 black-lined, or a final Version of Modifications to
3 the Proposed Conditions. Is that correct?

4 A. That's correct.

5 MR. HEYMAN: What I would like to do is
6 move for admission into evidence of Exhibits A-1, A-2
7 and A-3 and then allow Mr. Pignatelli the opportunity
8 to provide an oral summary.

9 ALJ RODDA: Any objections to A-1, A-2 or
10 A-3?

11 Okay. Then they are admitted.

12 MR. HEYMAN: Your Honor, at the end of
13 Mr. Pignatelli's oral summary, I would like to have
14 the opportunity to ask him to clarify what's behind
15 tabs one and two in his witness summary, which is the
16 modified conditions that we talked about.

17 ALJ RODDA: Thank you.

18 Q. (BY MR. HEYMAN) Mr. Pignatelli, please
19 proceed.

20 A. I would like to summarize my testimony
21 before I'm available for cross-examination.

22 I've been at the company for ten years,
23 and we run the company based on one thing: Do the
24 right thing. The right thing is safe, reliable
25 service and community involvement, and we will not

1 attach our name to anything that does not produce
2 safe, reliable service and community involvement.

3 What we have here before us today is, in
4 my opinion, the natural evolution in the development
5 of TEP and UES and UniSource. Since -- all during my
6 tenure at TEP and UES, we have been faced with costly,
7 narrow, irregular capital markets. Shareholders
8 change every two years and there is an extreme amount
9 of pressure on quarterly earnings per share.
10 Approximately ten percent of our shareholders are
11 hedge funds, and they profit on movements in financial
12 markets on company success, and I occupy 30 percent of
13 my time trying to meet the needs of the street on a
14 quarterly basis.

15 If approved, this transaction will give us
16 long-term owners. It will remove quarterly pressure.
17 It will increase our access to broader capital markets
18 and it will provide financial stability to TEP,
19 financial stability which has not been seen in
20 probably 15 or 20 years. The new owners will only
21 make a return on their investment if the company is
22 successful. And they know, just like I do, that the
23 success of this company depends upon customer
24 satisfaction, reasonable prices, and reliable service;
25 that it depends on continued community involvement and

1 it depends on a positive, constructive relationship
2 with the regulators, with the Arizona Corporation
3 Commission.

4 The Commission and I share common goals.
5 We both are responsible to the customer. We both are
6 responsible for the shareholder. We both are
7 responsible to the communities and we're both
8 responsible to the state. This transaction is merely
9 a change in shareholders. It may concentrate the
10 shareholders. Approximately 50 percent of our
11 existing stock is held by ten shareholders. But this
12 is not a boundary line case, a jurisdictional case.
13 It is not a rate case, it is not a DMS case. It is
14 purely a case to determine if there is no harm and if
15 this transaction of supplying TEP with long-term
16 ownership and financial security with commitments to
17 the community and commitments to this Commission is in
18 the public interest.

19 You've seen a lot of support from the
20 community, and some of you may say, yes, that is what
21 the company did for you yesterday, but what are you
22 gaining tomorrow from each of these individuals?
23 Those individuals are here because they trust us.
24 Many are here because they want continuity. They are
25 here because they see that what we have done all along

1 needs to be done tomorrow, but there needs to be more
2 assurances, more assurances that we have the
3 capability to continue to do what we've done.

4 I'm pleased that the mayor of Tucson, the
5 mayor of Prescott, the mayor of Flagstaff, the mayor
6 of Lake Havasu, the mayor of Williams, the mayor of
7 Show Low, the mayor of Nogales, the town of
8 Springerville, the town council of Cottonwood, the
9 Nogales city council, the Chino Valley town council
10 and various other political parties have supported us.
11 We have had positive support in editorials in the
12 Arizona Daily Star, in the Tucson Citizen.

13 Why are they here? Because they believe
14 that we act in the public interest and that this
15 merger is in the public interest, because it not only
16 passes the no-harm test but provides real and
17 meaningful benefits to all of the parties. I define
18 the public interest, I hope, similarly to you. I
19 define it as protecting and maximizing my shareholder
20 investment. I have a legal obligation to do that. I
21 define it as providing a safe and secure working
22 environment for my employees. I not only have a
23 contractual obligation to do that, but I have a moral
24 obligation to do that. I define it as making a
25 positive contribution to the communities which we

1 serve. And that is throughout our organization.

2 And, finally, I define it as providing
3 safe, reliable, adequate electric and gas service to
4 my customers. It's my regulatory responsibility. And
5 I believe that these are the elements that you as
6 Commissioners must factor in this case. If approved,
7 I believe that all parties are held harmless and
8 benefitted, and if denied, I believe that all parties
9 are harmed.

10 Let me look at each one of the
11 constituencies that I have to judge that on, and let's
12 look at the jurisdiction of utilities, TEP and UES.

13 If approved, financial health is returned
14 to TEP; \$165 million in new equity; \$90 million
15 receivable is paid off; approximately \$270 million in
16 debt is retired. And we have committed to retire \$400
17 million of debt by 2008. We have new sources of
18 capital for TEP and UES. UniSource Electric and Gas
19 benefit by the extension of \$40 million in revolving
20 credit, credit which we don't have now and which we
21 struggle to carry uncollectables in increasing gas
22 costs. We have \$40 million more to provide us
23 security of supply for the UES customers. We have
24 management continuity. Some may feel that's a
25 benefit, some may feel that's a detriment.

1 I can tell you the current management will
2 stay in place. I will sign a five-year contract and,
3 if you desire, I'll sign one for life. I can't
4 guarantee that if this transaction is not concluded
5 positively.

6 Moreover, our planning horizon is
7 lengthened. I no longer have to battle on day-to-day,
8 on quarterly earnings. I can now properly provide for
9 needed generation at UES to put the proper plans in
10 effect to continue to minimize the ultimate price to
11 the consumer. I can promise you that TEP becomes a
12 stronger, more vibrant entity.

13 If denied, I see continued slow
14 improvement in TEP. I see difficulty out in the
15 future of meeting customer demands. I see difficult
16 and narrow financial markets, shrinking financial
17 resources to TEP.

18 Let's look at the community, my second
19 constituency. If approved, management continuity.
20 And you've heard speaker after speaker indicate their
21 desire for management continuity in this organization.
22 The community has a first-class utility at this point,
23 one that they can be proud of, not a second-class
24 utility in the state of Arizona. You see continued
25 and enhance community involvement, not only in dollars

1 but in hours spent in the community. The utility
2 remains hometown. Our employees won the second time
3 of winning the Points of Light for community
4 involvement and voluntarism. We are the only company
5 in the country to have done that. And that is our
6 ethic, and that ethic stays if this is approved.

7 How about the employees if this is
8 approved? Management continuity, then you get the
9 same treatment tomorrow that they get from me today.
10 There will still be pressures on costs because that's
11 our obligations to consumers. Pensions and benefits,
12 there is no change. They will have a stronger company
13 to work for, maybe more security in their pension and
14 benefits. All collective bargaining arrangements
15 stay. There is no planned layoffs, there is no
16 planned sending work to India or outsourcing of any
17 kind. There is also the push for continued efficiency
18 which you hold me, you the Commissioners hold me
19 responsible for every day.

20 Let's look at the consumer. If approved,
21 all rate protections stay in place. There is no
22 change in the rate protections which you currently
23 have if this is approved. You the Commission still
24 review and approve all prices. The consumer benefits.
25 It has a stronger utility to work with. But, more

1 importantly, one of the conditions, we commit to
2 spending one and a half billion dollars through 2008
3 in maintaining reliable service and hooking up new
4 customers. That commitment, to put it into
5 perspective, is about ten percent higher than we
6 currently run. That is the commitment necessary to
7 assure these customers that they will have safe and
8 reliable service. The same protections that are in
9 place now carry over vis-a-vis the sale of assets. We
10 cannot split this company up. We cannot sell off
11 individual assets. The Commission has authority over
12 that. Commission approval has to be obtained for
13 that, and we propose no changes in that authority.

14 The consumer further benefits because of
15 the continuity of local management and local managers.
16 Cottonwood will still have its office, Prescott will
17 still have its office, Springerville will still have
18 our presence. Havasu will still have our office and
19 presence. I cannot guarantee that beyond today if
20 this is not approved. This protects the customer in
21 multiple ways.

22 Let's look at my fifth constituency.
23 Three of you are sitting at the desk. The Corporation
24 Commission. If approved, there is no change in
25 current rules and regulations. Prices, terms and

1 conditions of service remain the same. Asset sales
2 are prohibited without your approval. We can't loan
3 money between entities without your approval. We
4 can't borrow money without your approval. All of the
5 current protections remain the same, but you have 40
6 more protections, voluntarily provided, worked through
7 with the Staff. Those protections are local
8 management to the extent that you appreciate local
9 management. It's local offices. It's \$1.5 billion in
10 O&M and capital commitments, in hard commitments.
11 It's 40 percent equity, which we've been striving for
12 and which you have directed us to obtain. It's
13 additional debt reductions. It's commitment to
14 community involvement, which both of us are
15 responsible for, and it's a stronger, more capable
16 utility to serve rural Arizona. That's why it's in
17 your best interests.

18 Finally, the state. I believe the state
19 is one of our constituencies as a whole. As I said,
20 if approved, as other parties have testified to, or
21 submitted comments on, this is a vote of confidence
22 for investment in rural Arizona, an investment in
23 needed infrastructure for rural Arizona. The state is
24 benefitted because the utility is healthy. The state
25 is benefitted because we have local management and

1 community involvement is maintained and there is no
2 change, no change in the taxability of these entities
3 vis-a-vis the state of Arizona.

4 I cannot promise all those things if this
5 transaction is not approved. We all have obligations
6 to consumers and to shareholders and the communities.
7 I believe that this transaction will enable TEP and
8 UES to continue to provide safe and reliable service
9 to the state of Arizona. It will allow us to increase
10 our community involvement and it will secure the
11 future, a bright future, for our customers. I believe
12 that this is in the public interest. It certainly
13 meets the no-harm threshold and I believe it's in the
14 public interest to approve this transaction.

15 Q. Thank you, Mr. Pignatelli. What I would
16 like to do is have you turn now to your witness
17 summary, which has been admitted into evidence as
18 Exhibit A-3.

19 A. I have that before me.

20 Q. In opening statements this morning, there
21 was some mention made to the conditions that have been
22 stipulated to and the conditions that have been
23 proposed by the company. Are you familiar with those?

24 A. Yes.

25 Q. Tab one to your witness summary is a

1 Red-lined Version of UniSource's Modifications to
2 Proposed Conditions.

3 This document was prepared in response to
4 some issues raised in Commission Staff consultant's
5 surrebuttal testimony. Is that correct?

6 A. That's correct. We've been trying to
7 achieve acceptable language on the conditions
8 throughout this process and this, I think, is probably
9 the third or so iteration of these. But it was
10 prepared to attempt to respond and give the Staff
11 confidence in the conditions.

12 Q. You were present this morning when
13 Commission Staff's attorney in his opening indicated
14 that there were just a few items out of the 40 or so
15 conditions remaining that the parties were still
16 working on, were you not?

17 A. Yes, I was.

18 Q. What I would like to do is take you
19 through a couple of them and see if you can provide
20 some comment and information to the parties and to the
21 Commission as to where the company is now with regard
22 to those conditions.

23 A. Certainly.

24 Q. The first condition that I would like you
25 to turn to is on page six. And I'll refer to

1 Exhibit 1, which is the red-lined version. And it is
2 condition number seven, titled Waivers to Affiliated
3 Interest Rules.

4 A. Yes, sir.

5 Q. Is it your understanding that as this is
6 written, Commission Staff would still like the company
7 to make further modifications and that it will seek
8 Commission approval from, for all waivers in the
9 future?

10 A. Yes. That's my understanding.

11 Q. And what is the company's position with
12 regard to that at this time?

13 A. We would be more than happy. There's
14 quite a few waivers over time that have been obtained.
15 Some of them may or may not conflict with what is in
16 the present document. The company would be more than
17 happy to, within 60 days' approval of this
18 transaction, to resubmit all appropriate waivers as
19 well as have the existing waivers remain in effect
20 until the Commission can take action. I don't want to
21 have a waiver that we are resubmitting removed and
22 then it's found to be deficient in a Commission
23 filing.

24 So if the waivers can stay in place until
25 the Commission can take action, the company would

1 resubmit the appropriate waivers within 60 days of
2 approval of this transaction.

3 Q. And do you believe substantively, then,
4 that you are in agreement with the Commission Staff on
5 this term?

6 A. I believe we are, yes. I believe that
7 would make us in agreement.

8 Q. Great.

9 Now, if you could turn with me back to
10 page one of the red-lined version that you have.
11 Commission -- I'm sorry, Commitment 1d.

12 Do you have that in front of you?

13 A. Yes, I do.

14 Q. And that deals with this question about
15 debt retirement. Are you familiar with that?

16 A. Yes, I am.

17 Q. And is it the company's position at this
18 time that it would be willing to reduce up to \$400
19 million in prepayments and voluntary payments prior to
20 December 31, 2008? Is that correct?

21 A. That's correct. I think, when you talk
22 about debt retirements, we are talking here about
23 prepayment of debt, or prepayment of leases.

24 Q. That's correct. And is it your
25 understanding at this time that Commission Staff would

1 like that number, instead of \$400 million, to be \$500
2 million?

3 A. Yes.

4 Q. What is the company's position with regard
5 to that at this time?

6 A. I never want to be in the position of
7 having a condition that I can't meet. I feel an
8 obligation -- I won't put my name to something that
9 isn't understood and we will meet.

10 I am reluctant to go to five hundred for
11 two reasons: First is, in the same period of time,
12 we're going to be paying off another approximately two
13 to three million in debt on a normal payment schedule,
14 and we're coming, in my opinion, into a period when we
15 might have to go out and do some additional financings
16 because we're becoming short on generation, obviously,
17 as the Commission is aware of, 300 megawatts short on
18 UES generation and we are buying all that market --
19 all that power in the market under a contract with
20 Pinnacle. And I think it would be ill-found to, one,
21 commit to more than I was comfortable with, and,
22 secondly, to commit to prepaying tax-exempt debt,
23 which is very favorable price-wise at a time when we
24 may need additional financial resources to acquire
25 generation. That will only add costs, ultimately, to

1 the consumer and I just don't think that's the
2 appropriate course of action. And that's why I've
3 been reluctant to agree to more than the four hundred.

4 I would say that this involves an
5 additional \$120 million or so in additional debt
6 reduction, which will take us above the 40 percent
7 equity. So that's why I've been hesitant to commit to
8 that. I think that \$400 million is a large enough
9 piece. It shows us continuing to deliver the company
10 and it doesn't put us at a tough financial position at
11 a point in time when we might be looking at acquiring
12 generation or building generation to meet some of our
13 customers' needs.

14 (ALJ Rodda and Commissioner Mayes leave
15 the proceedings.)

16 Q. (BY MR. HEYMAN) Thank you,
17 Mr. Pignatelli. Is it fair to say, then, that the
18 company's position is that it is willing to abide by
19 the terms and conditions of exhibit 1d as it's
20 contained in the exhibit to your witness summary?

21 A. Yes, sir, it is.

22 Q. Could you now please turn with me to page
23 four, in particular the condition that's found --

24 COM. MUNDELL: Mr. Heyman, why don't you
25 just wait a second. You didn't see the administrative

1 law judge got up for a second.

2 (ALJ Rodda enters the proceedings.)

3 ALJ RODDA: I'm sorry.

4 MR. HEYMAN: That's okay. Commissioner
5 Mundell filled in aptly for you.

6 ALJ RODDA: What did I miss? Anything?

7 COM. MUNDELL: No.

8 MR. HEYMAN: What I was doing was
9 referring Mr. Pignatelli's attention to page four of
10 the exhibit one to his witness summary with regard to
11 the condition 2b.

12 Q. (BY MR. HEYMAN) Do you have that in front
13 of you?

14 A. Yes, I do.

15 Q. And this deals with some covenants that
16 Commission Staff and the company have been talking
17 about that would be attached to future financing
18 conditions. Is that right?

19 A. That's correct.

20 Q. And there's one provision in this
21 condition that the company and the Commission Staff
22 are still negotiating over. Is that correct?

23 A. Yes. That's correct.

24 Q. And that deals with the insertion of some
25 language regarding in the event of a bankruptcy of

1 UniSource Energy Corporation. Is that correct?

2 A. I think it revolves around attempting to
3 insert money -- excuse me, insert a recognition or
4 conditions in future financings by Saguaro.

5 Q. Could you --

6 A. Am I correct?

7 Q. You are correct. I said UniSource. It's
8 Saguaro.

9 Could you explain for us first what the
10 company's position is with regard to that.

11 A. The company's position, and it is the
12 position of the owners of Saguaro Holdings that they
13 will use their best efforts to put this language in
14 future financings. I don't know if lenders will
15 accept these or will find them commercially doable or
16 what the increased cost in a particular financing
17 would be because of the insertion of these covenants.
18 I can only promise my best efforts in this. And
19 I'm -- we're perfectly willing to do that but, once
20 again, I don't want to be accused later of agreeing to
21 a covenant and not making whole on that agreement.
22 This is more, "I don't know if it can be
23 accomplished." I'm willing to commit all our best
24 efforts to do it, but I can't guarantee it. And if I
25 can't produce something, I'm not going to sign it.

1 This does not in any way involve
2 jurisdictional utilities' debt or future debt
3 offerings. All of the conditions and requirements of
4 the jurisdictional companies have to be approved by
5 the Commission prior to us doing any jurisdictional
6 financing. This only goes to non-jurisdictional
7 financings at the holding company, and I just can't
8 promise it. And that's my position on that.

9 Q. To summarize your position, as I would
10 like to have it in the record, it's twofold: Number
11 one, you do not know if the terms of this condition
12 would be acceptable to lenders? Is that one of your
13 concerns?

14 A. That's correct.

15 Q. And the other concern is that you did not
16 have control over whether or not a lender will agree
17 to this language? Is that a concern?

18 A. That's correct.

19 MR. HEYMAN: Thank you. I appreciate
20 your allowing us to clarify those conditions. And
21 with that, I will tender Mr. Pignatelli for
22 cross-examination.

23 ALJ RODDA: Thank you, Mr. Heyman.

24 Mr. Meek, I'm going to ask you to go next,
25 please.

1 MR. MEEK: Thank you, Your Honor.

2 Before I proceed with Mr. Pignatelli, I do
3 want to say that I don't know how you're going to
4 resolve the confidentiality issue, but when you do, I
5 do want to weigh in on that to some degree because I
6 think there is a significant misunderstanding within
7 the Commission, in particular about what happens to
8 the evidence chain around here. I would be glad to
9 talk about that.

10

11 CROSS-EXAMINATION

12

13 Q. (BY MR. MEEK) Mr. Pignatelli.

14 A. Yes, sir.

15 Q. Good afternoon.

16 A. Good afternoon.

17 Q. I'm not going to take the Commission's
18 time or yours or mine in recounting all of the
19 information that has been filed by you in your direct
20 and rebuttal testimony and now in your summary.
21 Instead, I'm going to try to deal with some issues
22 that have arisen primarily in perhaps letters by the
23 Commission, public comments, issues that have come up
24 just fairly recently.

25 And the first thing I want to ask you is

1 this: Who is going to manage these utilities after
2 this acquisition is completed?

3 A. I am.

4 Q. Is that the same as saying that you're
5 going to be the boss at UNS and TEP?

6 A. That's correct. The same I am now.

7 Q. If someone has asserted that the limited
8 partners would be calling the shots, would that be an
9 accurate or an inaccurate statement?

10 A. You're damn right it would be an
11 inaccurate statement.

12 Q. Inaccurate?

13 A. Inaccurate.

14 Q. Thank you.

15 A. I will call the shots.

16 Q. If someone referred to the limited
17 partners as the new management team, would that be an
18 accurate or an inaccurate statement?

19 A. It would be an inaccurate statement.

20 Q. Thank you.

21 Now, I think you said earlier, we know
22 from what you said earlier that you are personally
23 committed to staying with UniSource for some period of
24 time. Is that true?

25 A. That's correct, sir.

1 Q. Who do you think is going to be the
2 management team after the acquisition?

3 A. It will essentially be the same management
4 team as is currently in place.

5 Q. Are you familiar with the objections or
6 the concerns that RUCO has raised about the
7 continuation of the management team? That is to say
8 that there does not seem to be any assurances that the
9 management team will stay in place?

10 A. I'm aware of that, yes, sir.

11 Q. Are you willing to do whatever is
12 reasonable to make sure that your management team
13 stays committed and stays in place?

14 A. Yes, I am.

15 Q. And, in fact, are you in the process right
16 now of negotiating or putting together employment
17 contracts for your current team that would include
18 potentially, at least, equity participation in the
19 company?

20 A. Yes, we are.

21 Q. What is your prognosis? What do you think
22 the likelihood is that you're going to keep these
23 people together?

24 A. High.

25 Q. High. Very high?

1 A. Very high.

2 Q. Okay.

3 A. I'll keep those that do a good job and are
4 ready to work hard.

5 Q. I'm going to ask you a couple questions
6 about this so-called compensation issue that has come
7 up a couple of times. But before I do that, I want to
8 ask you, what was the reason that the Strategic
9 Transaction Advisory Committee was formed?

10 A. The Strategic Transaction Advisory
11 Committee was formed by the board, made up of
12 independent directors, solely independent directors.
13 I was not included. I am the only insider on the
14 board. I was not included on the Strategic Advisory
15 Committee because it was determined by the board that
16 I was conflicted because of my stock ownership
17 position in the company.

18 So the Strategic Advisory Committee was
19 made up of totally independent board members looking
20 out for the interests of the company, the shareholder,
21 the community and the consumer.

22 Q. So part of the reason for forming that
23 committee was to make sure that any employees who had
24 potential conflicts based on compensation or
25 continuing employment or anything of that sort would

1 not be involved in that decision making?

2 A. That's correct. And I think it was a very
3 sound decision and I think the efficacy of that
4 decision was really pointed out when we had two
5 shareholder suits brought. And once they read the
6 process that the company had gone through, those
7 shareholder suits were withdrawn.

8 Q. Thank you.

9 Now, let me talk briefly about this, the
10 term that's been used here recently a couple times
11 about compensation that perhaps board members and
12 certainly some employees were going to receive as a
13 result of this transaction.

14 Is there in fact any real compensation
15 that's coming out of this transaction?

16 A. No, sir. There have been no severance
17 packages related to compensation. The only thing that
18 the officers or board members or anybody involved will
19 receive from that, receive from the transaction is
20 proceeds from the sale of their stock and/or stock
21 options. That's not compensation. These are
22 investments or deferred income items.

23 Q. I would agree.

24 And isn't it true that the vast majority
25 of the options were granted by your board before

1 these, before this transaction ever came to light?

2 A. All of them were. There have been no,
3 there's been no options granted subsequent to the --
4 nobody got options this year. I did not get any
5 options this year because the transaction had been
6 agreed to prior. So, if anything, I'm getting
7 underpaid this year.

8 Q. I could ask you to elaborate on that,
9 but -- no.

10 So, what the investors have agreed to do
11 is simply honor the option grants that were in place
12 before they arrived on the scene. Is that true?

13 A. Well, they just have to. The options vest
14 and have to be paid out as part of the sale of the
15 transaction.

16 Q. Right. So the investors have basically
17 agreed to live up to those option grants.

18 A. They didn't have any choice.

19 Q. Okay. That's fair. So, in other words,
20 they didn't have a choice, it's also fair, would you
21 say, for them to do that?

22 A. I think it's fair, yes.

23 Q. And if some buyer came along and cancelled
24 options that were already in place, what do you think
25 that would do to the morale of the organization's

1 management?

2 A. Well, first, they would get sued, and then
3 the second thing is that the morale would go to hell.

4 Q. And do you think it would discourage them
5 from wanting to continue with that organization?

6 A. Yes.

7 Q. I think you've already indicated this to
8 us, but what percentage of UniSource shares are now
9 owned or controlled by institutional investors?

10 A. Just prior to the transaction being
11 announced, about, a little over 70 percent was owned
12 by institutional investors. About 50 percent of it
13 was owned by ten institutional investors.

14 Q. What kind of institutions are these? Can
15 you characterize them in any way?

16 A. They range from longer term holders like
17 T. Rowe Price to hedge funds. There's a mix of
18 investors in that.

19 Q. Not to pin this all on the hedge funds,
20 what would you say would be the typical investor
21 horizon or the turnover time for these types of
22 investors?

23 A. Well, I can only say that based on the
24 volume in our stock, the average shareholder turned
25 over every two years.

1 Q. Every two years. A significantly shorter
2 time than you expect from the new investor group?

3 A. Yes.

4 Q. I think you've also already mentioned
5 this. I assume some of these institutional investors
6 call you and your managers sort of pretty constantly
7 about how you're doing and the decisions you make and
8 your financial performance?

9 A. Yes.

10 Q. I hope they call you at least as often as
11 they call me.

12 A. They probably do. And they comment every
13 quarter when I have my call.

14 Q. I believe your testimony, your direct
15 testimony indicated that the due diligence by the
16 investor group in this transaction covered a period of
17 something like 18 months. Is that correct?

18 A. Probably. I would accept that.

19 Q. In your experience with mergers and
20 acquisitions, is that an unusual period of time,
21 unusually long period of time?

22 A. I think there are two things that are
23 unusual, the length of time and the due diligence that
24 was done, and then the length of time that the
25 investors have actually been willing to tie up their

1 funds waiting for approval. I think that that's an
2 extreme amount of time.

3 Q. I know this is a very general question,
4 but from your perspective, what are some of the
5 effects of having the due diligence or the
6 investigation take place for that long a period of
7 time?

8 A. Well, some of the effects I think was a
9 better understanding by the investor in our, in
10 management strategies, a buying in by the investor in
11 management, in investment strategy, a new
12 understanding by the investors of management's
13 perspective and management's commitment to safe,
14 reliable electric service and the community
15 involvement and an acceptance by the investors of that
16 philosophy. There's, there was no rock unturned.
17 There was no can you cut this, can you do that, can
18 you do that.

19 We came in and we said these are our
20 five-year budgets, and they signed up and committed to
21 those expenditures, that one and a half billion
22 dollars. They understand that. They understand it's
23 necessary to run a system. We have talked that
24 through. They understand our business, they
25 understand management, they understand management's

1 commitments, and they have adopted and embraced them.
2 And that 18-month period was essential to that and it
3 gave me enough confidence that I would come here and
4 say this is the right thing to do.

5 Q. So you feel that you have learned to know
6 these entities pretty well?

7 A. Yes, sir.

8 Q. And their business objectives and their
9 philosophies?

10 A. Yes, sir.

11 Q. Do you also trust them?

12 A. Yes, I do. I've known some of them for
13 many years. But I'm also part of this community, and
14 I'm going to live here tomorrow and I'm going to live
15 here in the future. And they have to embrace that.

16 Q. Based on your understanding of and the
17 experience you've had with these people -- well, let
18 me back up a second.

19 Mr. Magruder in his opening painted sort
20 of a little chamber of horrors of expectations that
21 you might have from -- a chamber of horrors? Okay.

22 COM. MUNDELL: Term of the month.

23 Q. (BY MR. MEEK) About what might be
24 expected from a corporate merger. Do you have any
25 feeling based on your dealings with these people that

1 any of those possibilities are there?

2 A. I have no feelings -- I'm positive those
3 intentions are not there. I am positive that this
4 company will run as it is today. I am positive that
5 they will provide safe and reliable service and
6 community involvement. And why am I positive?
7 Because they committed. They are prepared to commit
8 in writing to ensure that a billion and a half dollars
9 are spent over the next four years in providing
10 necessary operation and maintenance expenses and
11 capital additions. And those were my numbers. Those
12 were my numbers to run this company, and they are ten
13 percent higher than we have been spending.

14 Q. Thank you. Just one last little item in
15 that regard.

16 Have you laid off a bunch of people in
17 Nogales recently?

18 A. No. We haven't laid off anybody. In
19 fact, I think there is more people working down there.
20 We have added ten people to UES Gas.

21 Q. Mr. Pignatelli, the last area I want to
22 spend a minute or two on is Commissioner Mundell's
23 letter which was dated June 10th in which, among other
24 things, he raised the question for all the parties of
25 whether or not it would be appropriate to delay

1 consideration of this transaction while the Commission
2 completed some sort of rate review.

3 Are you familiar with that?

4 A. I'm familiar with that, yes.

5 Q. I assume you answered Commissioner
6 Mundell, but I'm not privy to your answer so I'm going
7 to use another document to try to elicit your response
8 to that.

9 Your Honor, may I approach the witness?

10 ALJ RODDA: Yes.

11 Q. (BY MR. MEEK) Mr. Pignatelli, I'm going
12 to show you what has been marked for identification as
13 AUIA Exhibit 1. And while I pass this around, would
14 you try to familiarize yourself with that briefly.

15 A. Yes, sir.

16 COM. GLEASON: I think I got two.

17 MR. MEEK: You can have two.

18 COM. GLEASON: I don't read at both ends.

19 Q. (BY MR. MEEK) Mr. Pignatelli, can you for
20 the record identify what is stated at the top of this
21 document after the re.

22 A. Say the last. I missed it. As to what?

23 Q. Identify what this document says at its
24 top, right after the R-E, re.

25 A. Oh. It says Commissioner Mundell's data

1 request dated June 10th, 2004, in Docket No. E-04230A,
2 capital A, dash 03-0933, In the Matter of the
3 Reorganization of UniSource Energy Corporation.

4 Q. Now, Mr. Pignatelli, what I'm going to do
5 so that you don't have to do it is I'm going to read
6 the last four paragraphs of this letter into the
7 record and then ask you whether or not you agree or
8 not with the sentiments expressed there and whether
9 you know if the limited partners would also agree with
10 the position here.

11 So, starting with paragraph four:

12 "AUIA believes that any attempt to alter
13 TEP's rates while this acquisition is pending would
14 doom the transaction. Under the terms of the purchase
15 agreement, Saguaro Acquisition Corporation is not
16 obligated to complete the acquisition if required
17 regulatory approvals are not obtained or if regulatory
18 orders are issued that would have an adverse financial
19 impact on UniSource and its subsidiaries.

20 "Absent a decision in a fully litigated
21 fair value rate case, the Commission would have no
22 basis for lowering TEP's rates. The company's June 1
23 filing is not a fair value filing, nor is it intended
24 to trigger a full-blown rate case. After all, TEP has
25 no ability to obtain a rate increase because its rates

1 are capped by the settlement agreement. A litigated
2 fair value rate case would take at least a year after
3 an appropriate filing was made. In such circumstance,
4 we believe that the purchasers would simply terminate
5 the agreement.

6 "Consequently, if the Commission chose to
7 delay this matter pending a rate case determination,
8 we think the Commission would essentially be voting to
9 reject the merger without ruling on its merits."

10 Mr. Pignatelli, to what extent do you
11 agree or disagree with those comments?

12 A. I agree a hundred percent with what you're
13 saying. We all would love to see lower energy prices.
14 I don't need to go before disgruntled customers. But
15 if the truth really be known, TEP has had a 1.2
16 percent general rate increase since 1994. During the
17 same period, crude oil has gone up 280 percent;
18 natural gas has gone up 350 percent; gasoline has gone
19 up 62 percent; the CPI has gone up 26 percent. And it
20 all feeds into our costs.

21 I'd love to reduce rates, but I can't.
22 And as I indicated in my prior answer, I'm amazed that
23 this investor group has let their capital fallow and
24 stayed on this project for the period of time that it
25 takes to get regulatory approval. Any extension or

1 delay of that based on suppositions, naive
2 suppositions or duplicitous suppositions, is
3 unconscionable.

4 Q. So, to clarify for the record, it is your
5 belief that if this proceeding were delayed in order
6 to investigate a rate proceeding that the investors
7 would probably terminate the agreement?

8 A. I would if I were them.

9 MR. MEEK: Thank you.

10 Your Honor, that's all I have.

11 ALJ RODDA: Thank you, Mr. Meek.

12 Mr. Pozefsky.

13 MR. POZEFSKY: Thank you, Your Honor. If
14 I may, I'd like to sit here if that's okay so I can
15 have the benefit of my client sitting next to me.

16

17 CROSS-EXAMINATION

18

19 Q. (BY MR. POZEFSKY) Good afternoon,
20 Mr. Pignatelli.

21 A. Good afternoon, sir.

22 Q. I'd like to start by asking you some
23 questions about the terms of the merger, if I may.

24 Under the terms, the total purchase price
25 will be \$1.2 billion. Is that correct?

1 A. 1.2 million? Billion?

2 Q. Billion.

3 A. Excluding debt assumed.

4 Q. Okay. And of the \$1.2 billion, \$880
5 million will be paid to UniSource Energy's existing
6 stock and bondholders. Is that correct?

7 A. Existing stockholders.

8 Q. And up to \$263 million will be used to
9 increase TEP's debt-to-equity ratio and to pay TEP's
10 \$95 million in company loans. Is that correct?

11 A. That's correct.

12 Q. And since the debt-to-equity ratio has not
13 reached 40/60 yet, TEP is currently limited to pay out
14 75 percent of its earnings in dividends. Is that
15 correct?

16 A. We volunteered. Previous, we were allowed
17 to pay out, to dividend out 75 percent until we
18 reached 37.5 percent equity. And in the transaction
19 involving UES, we volunteered to move that to a 40
20 percent, so that if the equity ratio is not 40
21 percent, we cannot pay out more than 75 percent of
22 current earnings. Always current earnings.

23 Q. Okay. And up to this point, the other 25
24 percent that we've been -- that you can't pay out, has
25 that been used to retire debt or for other investment?

1 A. Or standing at the utility.

2 Q. And post-merger, my understanding is that
3 this should change because the debt-to-equity ratio
4 will increase to the 40/60 percent. Is that correct?

5 A. It's our intention to take the equity to
6 40 percent, and at that time that would permit us to
7 dividend out a hundred percent of current earnings.
8 Current earnings will be higher and so will cash flow
9 because we will have reduced \$270 million worth of
10 debt, also.

11 Q. So the other 25 percent that was going
12 back to the utility at this point, at least
13 post-merger, will now or could now be going to
14 shareholders. Correct?

15 A. That's correct. But it's not going back
16 to the utility. It was just never paid out in
17 dividend.

18 Q. Now, the proposed merger is not expected
19 to have any material impact on UniSource's other two
20 subsidiaries, UniSource Gas and UniSource Electric, is
21 it?

22 A. I believe it gives much more financial
23 security to those two entities. Think of the \$40
24 million in revolving credit that's being provided. On
25 a \$220 million investment, we now have increased the

1 liquidity of that entity by \$40 million. That's
2 significant, about 20 percent of the original cost.
3 There's tremendous benefit to UES on financial
4 stability and security.

5 Q. So post-merger, then, is it fair to say
6 that you expect these other two subsidiaries,
7 UniSource Gas and UniSource Electric, to generate more
8 income than they have in the past?

9 A. That's a function of revenue and expenses.
10 This doesn't increase the earnings of those two
11 entities. It only gives them more financial security
12 by providing additional available liquidity. It
13 doesn't reduce their costs.

14 Q. Then I think that would probably answer my
15 next question, which would be that post-merger, the
16 majority of the earnings that UniSource Energy will
17 generate will be through TEP.

18 Would that be fair to say?

19 A. That would be fair to say.

20 Q. And the ratio of earnings that will be
21 generated by TEP post-merger, as compared to the ratio
22 of the earnings that it produces now, would be
23 similar. Would that be fair to say?

24 A. I don't understand your question. I'm
25 sorry.

1 Q. You don't expect TEP to generate any less
2 of a percentage of earnings totally post-merger than
3 they do now. As a percentage of UniSource's earnings.

4 A. Yes. It would generate less because we
5 haven't had a full year's ownership of UES Electric
6 and Gas. So UES Electric and Gas in a full year will
7 represent a higher percentage of the total combined
8 organizations than it did last year.

9 Q. Okay.

10 A. So, TEP's percentage will go down.

11 Q. Historically, just looking over the last
12 five years, TEP's percentage has been, what,
13 approximately 90 percent of the total earnings?

14 A. Sir, we've only owned UES Electric and Gas
15 for -- since last August. So when you go back five
16 years, TEP was essentially the whole entity.

17 Q. Okay. So --

18 A. The only other aspect was the solar and
19 the renewables that they were investing in.

20 Q. That's fair. Then prior to the time,
21 prior to the time that UES and UES Gas came into
22 existence, UniSource was generating a hundred percent
23 of its income from TEP. Is that correct?

24 A. On an ongoing basis, essentially. There
25 were some minor profits and losses at the unregulated

1 entities.

2 If you're speaking of jurisdictional
3 assets, up until last August, TEP contributed a
4 hundred percent of the jurisdictional returns.

5 Q. And since that time, since the two
6 subsidiaries came into existence, would it be fair to
7 say that TEP generated over 90 percent of the total
8 income?

9 A. On a partial year, 2003, TEP contributed
10 probably 90 percent of the jurisdictional earnings.

11 Q. Okay. And as you said, post-merger,
12 assuming the merger is approved, you expect TEP to, to
13 generate less as -- generate less as a percentage of
14 the total earnings as a result of the fact that the
15 subsidiaries will produce more. Would that be fair?

16 A. That's correct. We will have a full year
17 at UniSource Electric and Gas and they will contribute
18 a slightly higher percentage than they did in 2003.
19 And of the jurisdictional utilities, TEP will thereby
20 produce less percentage of the jurisdictional income.

21 Q. Let's talk about just TEP.

22 A. Okay.

23 Q. I mentioned about the last five years and,
24 as we've discussed, TEP, for at least four of them,
25 represented 100 percent of the income. So what I

1 would like to know is TEP has generated an annual
2 average of \$60 million in income for UniSource, is
3 that correct?

4 A. I think that's a little high. I think you
5 probably have income from a change of accounting in
6 there. No. We don't run \$60 million a year income at
7 TEP.

8 Q. What would be, to the best of your
9 knowledge, an average annual income?

10 A. You're talking about on an accounting
11 basis or on a GAP basis or on a jurisdictional basis?

12 Q. An accounting basis.

13 A. Pardon me?

14 Q. An accounting basis.

15 A. Well, you have things that are so
16 aberrational, I don't have that. In one year alone,
17 we had \$60 million plus in accounting income.

18 Q. Well, let's just assume for purposes of
19 our discussion, we'll use \$60 million and I will ask
20 you some more questions about that.

21 A. That's too high for purposes of a
22 hypothetical.

23 Q. Let's go back.

24 Our holdings will be borrowing \$660
25 million to make this merger possible. Is that

1 correct?

2 A. That's my understanding.

3 Q. And UniSource is going to have to pay this
4 back. Correct?

5 A. No.

6 Q. Who is going to pay it back?

7 A. That's Saguaro's problem.

8 Q. So do you know, is there a formal
9 agreement at this point on how this money is going to
10 be paid back?

11 A. No.

12 Q. You don't know, or there is no agreement?

13 A. There is no formal agreement.

14 Q. And Saguaro is going to generate any
15 income that it's going to produce at this point from
16 TEP. Is that correct?

17 A. Saguaro will receive dividends as a
18 shareholder of UniSource.

19 Q. And that's basically the sole source of
20 revenues derived. Is that correct?

21 A. That's my understanding, yes.

22 Q. So it is expected that Saguaro is going to
23 pay this money back over some period of time from the
24 monies that it generates primarily from TEP. Correct?

25 A. I can't make that assumption. I can make

1 the assumption that Saguaro will service whatever
2 they -- debt they have from dividends which they
3 receive. Whether they pay down the debt or refinance
4 the debt, Saguaro, that's Saguaro's risk.

5 Q. So you're not familiar, basically, with
6 how Saguaro is going to pay back this \$660 million.

7 A. I just said the only thing that they can
8 look to me for is dividends, and I am limited to a
9 hundred percent of current earnings but only if I
10 maintain 40 percent equity. That's the only call they
11 have on TEP or UniSource Electric and UniSource Gas.
12 Only on dividends. And the only money we can dividend
13 is current earnings and only if we maintain 40 percent
14 equity. Whether they refinance their debt or what
15 they do, whether they issue equity to take their debt
16 out, that's in their financing plans, not mine.

17 Q. So the answer to my question is yes,
18 you're not familiar with exactly how Saguaro intends
19 to repay back that \$660 million.

20 A. That's correct.

21 Q. But you will admit that the revenues that
22 are produced or that are generated by TEP will be used
23 to refinance or to retire that debt. Is that correct?

24 A. No, I will not. If you say dividends, I
25 will agree, but I won't say the revenue of TEP.

1 Q. Okay. Let's say the dividends. You would
2 say the dividends that will be produced or generated
3 will be what's used to pay back that debt. Is that
4 correct?

5 A. As I said, I don't know if they'll pay
6 back the debt or service the debt with that. I'm only
7 saying as shareholders, just like our current
8 shareholders, they are only entitled to dividends and
9 they are only entitled to dividends if we maintain 40
10 percent equity, and they are only entitled to
11 dividends to maximum of current earnings, just like we
12 are now.

13 Q. I would like to turn, Mr. Pignatelli, to
14 the \$557 million that Saguaro LP will be paying to
15 Saguaro Holdings. Okay? Well, will be contributing.

16 Now, my understanding is that's an equity
17 contribution. Is that correct?

18 A. No.

19 Q. In other words, Saguaro LP, is it your
20 testimony, will not be making an equity contribution
21 of \$557 million to Saguaro Holdings?

22 A. I'm speaking of equity contributions to
23 TEP. That's \$165 million.

24 Q. Right.

25 A. Now, you just changed the question. Why

1 don't you ask me the question you want to ask.

2 Q. My question is, the \$557 million that
3 Saguaro LP will be contributing to Saguaro Holdings,
4 is that an equity contribution?

5 A. That's my understanding, it is their
6 equity, yes.

7 Q. And so, also, isn't it true that there
8 will be no notes and UniSource Energy is under no
9 obligation to pay Saguaro LP back? Is that correct?

10 A. That's correct.

11 Q. And prior to the future sale of UniSource
12 Energy as you understand it, will the only income that
13 Saguaro LP will receive would be from dividends?

14 A. Yes. That's my understanding.

15 Q. And it's anticipated that the sale of
16 UniSource Energy will not take place until 2008?

17 A. The sale of UniSource Energy?

18 Q. Right. The post --

19 A. You mean if Saguaro wants to sell
20 UniSource?

21 Q. Yes.

22 A. I don't know when that would happen.

23 Q. Are you aware of a horizon that the
24 investors intend to hold on to the company?

25 A. My understanding is these investors have

1 historically, the average holding period is around
2 eight years, but they've held investments longer than
3 that. So 2008 falls very much short of that eight
4 years. That's why I was wondering why you used 2008.

5 Q. Okay. That's fair.

6 So, based on their average, it would be,
7 what, 2012?

8 A. Hopefully, if this proceeding gets done.

9 Q. Can't guarantee that.

10 And the entity that buys UniSource Energy,
11 there are no restrictions from requesting an
12 acquisition premium. Isn't that true?

13 A. You mean when Saguaro exits its
14 investment?

15 Q. Yes.

16 A. You --

17 Q. There are --

18 A. No. There are no restrictions. That's
19 their profit. That's the American way.

20 Q. Let's shift focus here for a second,
21 Mr. Pignatelli. Let's go to the employment issue.

22 A. Certainly.

23 Q. Now, would you agree with me,
24 Mr. Pignatelli, that the reason why the management
25 team, the current management team will continue to

1 manage is because they are familiar with the industry
2 and have been successful over the last couple of
3 years? Would that be a fair statement?

4 A. Could you repeat that first?

5 Q. Would you agree with me that the reason
6 why your current management team will continue to
7 manage is because the team is familiar with the
8 industry and has been successful over the last couple
9 of years? Would that be a fair statement?

10 A. I'm basically the newest of the management
11 team. There is only one that's been hired since I
12 was. And that's ten years.

13 Q. No, no. I don't think you understand my
14 question.

15 The current management team, basically the
16 understanding, the reason why it's going to continue
17 to manage post-merger is because it's been successful
18 and has a working knowledge of the industry. Is that
19 correct?

20 A. The management team will stay because they
21 like to do what they're doing. I, I don't -- the
22 thrust of your question is illogical to me. They are
23 not staying because they have been successful the last
24 two years. The management team has been around for
25 ten years or more. That's my answer to you. And they

1 like the work environment.

2 Q. Well, all right. I --

3 A. We are having a failure to communicate, I
4 think.

5 Q. No, no. I think we are seeing it from two
6 different perspectives, and it's my fault because
7 perhaps I'm not clear. I think I'm looking at it from
8 the perspective of how your investors would be looking
9 at this.

10 A. Okay.

11 Q. How your investors would be looking at it.
12 And if you have any reason to disagree, please let me
13 know.

14 The reason why it would be appropriate and
15 it would be beneficial to keep you around would be
16 because you've been successful in moving the company
17 forward. Would that be fair to say?

18 A. I thought it was because I had a pretty
19 face.

20 The investors are making this investment
21 in a management that they feel they trust. They are
22 not day-to-day investors -- operators. They aren't
23 going to operate these assets. They are looking at
24 buying a company with sound, solid management with a
25 track record of improvement and in the utility

1 business with a concern for the customer and safe,
2 reliable service, with high marks in community
3 involvement, where their investment can be safe and
4 can grow. They believe that this management team,
5 based on its performance over the last ten years with
6 me, is the management team they want to invest in.

7 Q. That's fair. But your answer is basically
8 yes to my question.

9 A. No. My answer is not yes to your question
10 because you prefaced it on two years. This is not a
11 two-year business. This is a long cycle business and
12 they are looking at our performance, at what we have
13 done for this company and for this community over the
14 last ten years, not two years.

15 Q. Okay. Well, let's take it back and say
16 ten years, over the last ten years. Then you would
17 agree with me, would you not?

18 A. Probably partially because I just gave you
19 that answer. But -- go ahead. I'll take a ten-year
20 horizon.

21 Q. And what you've just told me, also, is
22 that you believe or you understand that these
23 investors -- and I take that back. Maybe you didn't
24 tell me that. So I'm going to tell you and you tell
25 me if I'm correct.

1 Would you agree with me, Mr. Pignatelli,
2 that it would be fair to say that these investors do
3 really not know how to operate an electric utility?

4 A. I think they have the intelligence to but
5 it's not their business. They have experience in
6 other electric utilities and they certainly
7 understand the energy business, but it is not their
8 function to be day-to-day managers and operators.
9 That's just -- some people operate, some people don't.
10 It's just not their gig.

11 Q. Have they expressed an interest to you in
12 becoming day-to-day operators?

13 A. No. They don't want to become a
14 day-to-day operator. They might like to understand
15 it, but they do not intend to be a day-to-day
16 operator. This is my company to run.

17 Q. So they intend for you and your management
18 team to be the day-to-day operators exclusively.
19 Correct?

20 A. That's correct.

21 Q. And would it be fair to say that the
22 day-to-day decisions will be made by you and your
23 management team?

24 A. Yes, they will be.

25 Q. At every level, will those decisions be

1 made by you and your management team? In other
2 words --

3 A. Yes. The day-to-day, yes.

4 Q. So they will have no input in the
5 day-to-day decisions at any level. Is that correct?

6 A. No. I think -- maybe there is some
7 failure to communicate on certain levels.

8 Day-to-day operations is a function of my
9 position, the CEO. I will report to a board. That
10 board has a fiduciary responsibility to shareholders,
11 but the board functions -- this board which we will
12 have, five-person board, just like my current board,
13 it functions as a fiduciary responsibility to the
14 shareholder, but it focuses on strategy, financial
15 matters, not budgets and things of that, but financial
16 refinancings and things of that nature and succession
17 planning within the organization. The board operates
18 to increase value, and that's what it will continue to
19 do.

20 Now, that board will be made up of one,
21 one out of five representatives of the investors,
22 Saguaro will have one board member. There will be
23 four other board members. And our current intention
24 is to bring three of our existing board members over.
25 Two of the board members will be independent. At

1 least two of the board members will be independent and
2 at least two will be from Arizona. So maybe that
3 helps a little. And it goes maybe to some of
4 Mr. Kempley's comments, or concerns on how this whole
5 structure works. I think you have to understand that
6 any board of any company has a fiduciary
7 responsibility to shareholder, but that board only
8 functions, a good board only functions relative to
9 strategy, refinancing, financial decisions and
10 succession planning. Operating is left to the CEO.
11 Whether you like it or not, I'll be there for five
12 years as CEO. So you'll live with my operating
13 decisions.

14 Q. So the board that we're talking about will
15 have at least two representatives from Arizona. Is
16 that correct?

17 A. That's correct. That's in one of our
18 proposals, conditions. That is a condition of this
19 proposal. And two independent.

20 Q. And is there any distinction as to the
21 other three members, where they will be from?

22 A. A total of two have to be independent, but
23 there's no locational restrictions on them.

24 Q. Let me ask you a question, Mr. Pignatelli,
25 one of many.

1 Let's say two years down the line
2 investors decide, you know, this company, it's not
3 what they have cut out; they need to rebalance. They
4 are taking a look at their portfolio and they decide
5 we want to run this utility at a loss just so we
6 balance out our portfolio; too many other things are
7 doing really well so we have decided we are going to
8 run this thing at a loss. And that's how they decide
9 they are going to start running it.

10 What -- if they decide that, what can you
11 do?

12 A. I don't understand your point. Run it at
13 a loss? You have to define that to me.

14 Q. They decide not to put money in it to
15 upgrade the infrastructure, they decide that they are
16 not going to pay the sort of attention that you have
17 expressed your desire and commitment to do. In other
18 words, they decide they are going to change their mind
19 and their whole philosophy. And you, of course, being
20 a member of management -- which we will get to what
21 level you'll be at. But before we get to that, let's
22 say they get to that point, that's where they are at
23 in two years. They change their whole philosophy.

24 What, if anything, can you do?

25 A. Well, for one thing, the board has two

1 independent members. They have one -- and two Arizona
2 members. But you're forgetting one primary condition
3 that they are agreeing to: \$1.5 billion. That \$1.5
4 billion, I can sit here and tell you that I can run
5 this system reliably, safely, in the interest of the
6 customer and the interest of the community. Five
7 years, \$1.5 billion. Four years. I'm sorry. I
8 misspoke. This Commission can call me in if I'm not
9 spending that money.

10 If they want to run this company at a loss
11 at the end of two years, they can't do it because of
12 those conditions. This Commission can call me any
13 time, call me in any time to show cause why safe and
14 reliable service is not being supplied. None of that
15 changes. It doesn't matter what they decide. They,
16 the investors. This Commission has the complete
17 authority that they have now.

18 And I tell you my current investors aren't
19 going to underwrite \$1.5 billion. My current
20 investors aren't going to put additional money in.
21 The status quo isn't what you think you have. The
22 status quo is weak financial opportunity for TEP.
23 This is financial stability and security for our
24 customer.

25 Q. It's financial security, Mr. Pignatelli,

1 for your customer, but \$1.5 billion may not be a whole
2 heck of a lot of money to a company like KKR or to
3 JPMP. So they may -- I'm not saying they will. I'm
4 just saying that they may have a different view of
5 \$1.5 million than you do. And if they do, and they
6 decide to change their thinking, your answer is that
7 it's the Commission that would be the ones that would
8 make sure that won't happen. Is that correct?

9 A. They can't take the \$1.5 billion out of
10 this company. That's my cash flow that's in there.
11 They can't take it out. Those plans don't require
12 them to put more money in. If I bring a plan to them
13 that requires more money, I'll get it.

14 Q. Okay. Mr. Pignatelli, at this point,
15 isn't it true that neither you nor any member of your
16 management team has signed an employment contract with
17 Saguaro LP?

18 A. Well, we wouldn't sign it with Saguaro LP.
19 That would be management contracts. It would be TEP
20 and UniSource.

21 Each one of the officers have a five-year
22 contract now as a result of the first stage of a
23 change of control. They have automatic five years.
24 We are in the process right now of preparing the new
25 terms and conditions for new contracts. But right

1 now, they have five-year contracts and I'm in the
2 process of negotiating new contracts with them.

3 Q. I don't want you to take this as, like I'm
4 looking for some sort of trick question, but I've read
5 those change of control provisions in the application.
6 As I read them, they were very much written for the
7 security of the employees. In other words, if they
8 should be demoted or if they should be terminated or
9 whatever, that there would be ample compensation for
10 them. But I didn't necessarily see it go both ways.

11 How do you respond to that?

12 A. Those change of control documents were
13 prepared -- they are quite old. They are before I
14 came. But you're correct. They are for the long-term
15 security of the employee at this point in time. But
16 I'm in the process now of negotiating the terms and
17 conditions for the next five-year contract for these
18 individuals that will take the place of those change
19 of control documents.

20 Q. When do you anticipate some finality on
21 those agreements, those documents?

22 A. Certainly, we should have them before the
23 Commission acts. I would anticipate within the next
24 six weeks to two months.

25 Q. Let's go to your rebuttal testimony if we

1 may.

2 ALJ RODDA: Mr. Pozefsky, I need to stop
3 you right here. Let's take a ten-minute break right
4 now.

5 (A recess ensued.)

6 ALJ RODDA: Let's come back to order.
7 Mr. Meek is at the podium.

8 MR. MEEK: May I ask a brief
9 interruption? I neglected to move AUIA-1.

10 ALJ RODDA: Okay. And just for one's
11 recollection, AUIA-1 was your response to Commissioner
12 Mundell's --

13 MR. MEEK: Letter response to
14 Commissioner Mundell's data request.

15 ALJ RODDA: Does anyone have an objection
16 to AUIA-1?

17 Hearing none, it will be admitted.

18 And, Mr. Heyman, you wanted to help us
19 out?

20 MR. HEYMAN: Yes. Thank you, Your Honor.

21 We have had an opportunity to review the
22 notes to the special committee which has been called
23 the STAC committee, and we would be willing to have a
24 limited waiver of that information. Let me explain
25 what I mean by limited waiver and our reasons why.

1 We would consent to having any information
2 in the documents revealed during the course of a
3 question or an answer. We would just ask that the
4 documents themselves not be admitted in as exhibits
5 and not be attached to any transcript. So if somebody
6 wanted to go through and read the whole thing, I guess
7 that would be okay. The documents themselves, we
8 would like to keep still some degree of
9 confidentiality, recognizing that anything that's on
10 them could be subject to a question and could be
11 subject to an answer.

12 COM. MUNDELL: May I?

13 ALJ RODDA: Yes.

14 COM. MUNDELL: Thank you for that. Thank
15 you for your agreement on behalf of your client, but
16 there are other minutes than the quote/unquote STAC
17 minutes, the Strategic Transition Advisory Committee.
18 There are also minutes of board meetings, minutes of
19 special meetings, so I'm not clear what you are
20 agreeing to.

21 MR. HEYMAN: At this point, we are just
22 agreeing to the STAC committee minutes. We do want to
23 reserve confidentiality of the board minutes. But,
24 Commissioner Mundell, if there is a way that we could
25 know which board minutes, we would undergo the same

1 process. I think everybody can appreciate the need to
2 keep board minutes confidential and so we don't want
3 to give a blanket waiver and have that set some sort
4 of precedent for the company, but we do want to allow
5 you the opportunity to question witnesses on the
6 information contained in that.

7 I do want to put on the record with regard
8 to the STAC minutes the reasons why we are waiving it
9 so that it's clear in the future what we did and why.

10 But for the fact that Commissioners
11 requested it during the course of this proceeding, we
12 probably would not have acceded to the waiver, so we
13 want to make clear that is one of the reasons, that we
14 believe that the Commissioners were requesting it
15 during the course of this proceeding and, in response
16 to that, we are agreeing to this limited waiver.

17 The second thing is in reviewing the
18 information, there was some time sensitivity in
19 keeping things confidential which was the basis for
20 the claim initially. Analyzing things, enough time
21 has passed that some of the sensitivity has been
22 desensitized, and so we are using that as a factor for
23 this limited waiver as well.

24 Again, I want to go back to Commissioner
25 Mundell's point. If that is possible, Commissioner,

1 to know which board minutes, we can look back and give
2 you the same type of information. If not, we may have
3 to kind of, I guess, go on a case-by-case basis.

4 COM. MUNDELL: I will now try to give you
5 a list, but I think I have a question from probably
6 each one of the minutes of the board meetings.

7 I'm looking at September 16th. I have
8 some tabs on that. I'm looking at October 13th of
9 2003. I've got tabs on it. I think there was a
10 November 18th meeting of 2003. I've got tabs on that.

11 So I'm not sure how to answer your
12 question other than it was a great Father's Day
13 yesterday. I went through this, my wife kept telling
14 me to put it down and, you know, participate with the
15 family. But I'm just saying I've tried to go through
16 each one of those minutes and tab where I may have
17 questions.

18 MR. HEYMAN: Maybe this would be a good
19 starting point for us, Commissioner. If there is a
20 beginning board minute that you're looking at and an
21 ending one, at least that narrows the parameter for us
22 and we can start looking at that, recognizing that you
23 may have a question in between. So, for example, if
24 the first one is September 16th of 2003, we know that
25 you're not going to be addressing ones beforehand,

1 that will narrow our focus.

2 COM. MUNDELL: I don't think I'm going to
3 get to you today anyway, so I will try this evening to
4 just make a chronological order, then, of the minutes.
5 But I'm just trying to be as straightforward as I can
6 be. I think I have a question from each one of the
7 minutes that you provided to me on Friday.

8 MR. HEYMAN: Okay. Well, if that's the
9 case, then you've already defined for us the documents
10 that we need to look at. And rather than have you go
11 through the list, we will take it tonight and we will
12 come back and give you the response on that. Thank
13 you. That is helpful and that does narrow it for us.

14 ALJ RODDA: Thank you, Mr. Heyman.

15 Mr. Pozefsky, I'm sorry I interrupted you.
16 But you may resume.

17 MR. POZEFSKY: Thank you.

18 Q. (BY MR. POZEFSKY) Mr. Pignatelli, let's
19 take a second. In your rebuttal testimony on page 21,
20 you state: Second, discussions have occurred recently
21 regarding post-merger employment arrangements for
22 members of the management team.

23 Do you recall saying that? Take a second
24 if you need to see it. Page 21, line four and five.

25 A. What line are you referring to?

1 Q. Line four and five, page 21.

2 A. Yes. I see that, yes.

3 Q. Now, Mr. Pignatelli, would you agree with
4 me that your equity position in the company currently
5 is going to change as a result of the merger?

6 A. Yes.

7 Q. And to what extent it's going to change,
8 you don't know at this point. Correct?

9 A. It's not going to change a material
10 amount. I believe that right now, with outright
11 ownership stock that I have purchased and options, I
12 control one to two percent, or have an economic
13 interest in one to two percent of the company. I plan
14 on, and have discussed it with the investors, of
15 investing \$5 million in the new company. And five
16 million to five hundred and some million would be
17 about one percent. So it's still going to be an
18 approximately equal amount.

19 Q. That's not any part of the merger
20 agreement or anything like that, is it?

21 A. It's part of my current negotiations
22 vis-a-vis my contract.

23 They wanted the microphone away. Do you
24 want it closer now?

25 ALJ RODDA: Maybe.

1 THE WITNESS: Okay.

2 Q. (BY MR. POZEFSKY) Now, are you familiar
3 with the negotiations going on with the rest of your
4 management team?

5 A. I have just presented them a term sheet
6 vis-a-vis their investment opportunity. I have not
7 sat down to discuss wages and bonuses with them, but
8 they will be in the same range that they currently
9 have.

10 The investment of each one individually in
11 the new entity I think will, a lot will be at their
12 discretion. We have given them some term sheets, like
13 I say. I have not gone back to see if the investment
14 that I would like to see them make is consistent with
15 their current percentage ownership of stock and
16 options.

17 Q. Are the investors making that offer for
18 the current management team to the other people, that
19 they would be able to invest in a percentage
20 equivalent to what they currently have?

21 A. The investors are -- have made it known
22 that they desire and expect management to invest their
23 own proceeds back into the new entity.

24 Q. So --

25 A. I can't tell you it's on the, exactly

1 equivalent, but all of management knows that the
2 investors are giving them the opportunity. One would
3 like to see them as investors.

4 Q. So you know at this point, at least with
5 regard to yourself, that an accommodation will be made
6 between you and the investors for you to continue
7 post-merger, provided the Commission approves it.
8 Correct?

9 A. You'll have to clarify accommodation. I'm
10 sorry.

11 Q. Sure. An agreement will be made between
12 you and the investors at this point which will allow
13 you to continue post-merger. Correct?

14 A. To continue working and to make a personal
15 investment to participate in the company, both as an
16 employee and as an investor, yes. In fact, at one
17 point in time, it was a condition to the agreement
18 that had been specified by the investors that I sign a
19 five-year contract.

20 Q. Is it a condition now?

21 A. Their condition, yes. They would not do
22 the transaction unless I agreed to a minimum five-year
23 contract.

24 Q. Is that in the agreement?

25 A. It's not in the agreement. I thought it

1 was in there. It's not in there, but it's my
2 commitment to them, is that I would entertain -- I
3 would execute a five-year, minimum five-year contract
4 with them prior to the closing of the transaction and
5 that I would invest my own personal funds in the
6 transaction.

7 Q. And at this point, is that understanding
8 just a verbal commitment?

9 A. I have a handshake with it and my
10 handshake is my bond.

11 Q. Has the same sort of agreement,
12 understanding, been made between the investors and
13 other members of your senior management?

14 A. They haven't shook hands but they know
15 that I want them to stay and they know that they're
16 going to have five-year contracts.

17 Q. Let's say hypothetically an agreement
18 can't be reached between the investors and let's say
19 Mr. Glaser. What would you do?

20 A. I personally would feel a loss and have to
21 figure to out how to run it without Mr. Glaser. But
22 I'm confident I can persuade Mr. Glaser.

23 MR. HEYMAN: Mr. Glaser would like
24 Mr. Pozefsky to ask some questions on his behalf now
25 if that's okay.

1 THE WITNESS: I have tried to be complete
2 in my answers to you without limiting my ability to
3 negotiate.

4 MR. POZEFSKY: I understand.
5 Can I just have a second, Your Honor?

6 ALJ RODDA: Yes.

7 Q. (BY MR. POZEFSKY) You don't expect,
8 Mr. Pignatelli, to have any of these agreements
9 signed, these employment agreements signed prior to
10 the time the Commission decides this matter, do you?

11 A. Actually, I think in answer to my last
12 question before the break I said I was going to
13 endeavor to have them signed in the next six weeks to
14 two months. And I think that that time frame would
15 probably be consistent with the final determination in
16 this matter.

17 Q. Would you or the company be willing to
18 delay this matter until a final agreement has been
19 reached in order that the Commission and the parties
20 could take a look at any of these agreements?

21 A. No. I would not on behalf of the company
22 submit to that because you take away my ability to
23 negotiate. If I have to negotiate with a deadline or
24 a gun against my head, then I can't negotiate and
25 ultimately be fair to the consumer. I told you I'm

1 going to make my best faith effort to get them done
2 prior, but I'm not going to give an inordinate
3 increase in salary or some other benefit which
4 ultimately has to be paid by the consumer simply to
5 get something that's the right thing to do done.

6 Q. Don't you think that it would be
7 beneficial to the Commission as well as ratepayers in
8 general to know that there's been some final
9 agreements in writing regarding employment status
10 prior to giving approval on this deal?

11 A. No. I don't think that's necessary. I'll
12 have mine done and then you're going to have to give
13 me a hierarchy of the officers that you'd like to see
14 hired and then I'm going to have to negotiate against
15 that. No. I'll have mine done and I'll have a
16 management team in place and I think it will be done
17 prior. And it will be the existing management team.

18 Q. Okay. Do you consider anybody,
19 Mr. Pignatelli, including yourself, indispensable to
20 the current management team?

21 A. I was always taught as a youngster to take
22 a glass of water and stick your finger in it and pull
23 it out and see if there was a hole there.

24 Nobody is indispensable. Even myself.

25 Q. So if, God forbid, Mr. Pignatelli -- and I

1 sincerely say this -- something should happen to you,
2 let's say prior to the time -- let's say tomorrow,
3 would you believe that the current management team
4 could operate as efficiently and as effectively
5 without you post-merger?

6 A. No. But that's ego talking.

7 Q. Okay.

8 A. As I indicated, one of the primary
9 responsibility of the board, and a primary
10 responsibility of mine, an obligation to the board and
11 to the shareholders, is continuity of management and
12 succession in training and education of employees.
13 And that is a continuous process.

14 Do I think I can be replaced? No. But if
15 I stick my finger in that glass of water, I know I
16 don't leave a hole when I pull my finger out. Nobody
17 is indispensable. Some people are more important than
18 others. Would this company be less without me? I
19 think it would be less without me. Am I trying to
20 provide for appropriate succession within my
21 management team, yes.

22 Q. Mr. Pignatelli, as a result of the merger,
23 how much will each member of the management team make?

24 A. I didn't understand what you said.

25 Q. As a result of this merger, how much will

1 each member of the management team make as a result of
2 the sale of their stock?

3 And if that's confidential, I would defer
4 to you, Ray.

5 MR. HEYMAN: No. I believe that
6 information is in the proxy, so we wouldn't claim any
7 confidentiality on that.

8 THE WITNESS: Can I be provided the -- he
9 is asking as a result of the merger. The merger only
10 provides the difference between the market price of
11 the stock at 18 or 19 dollars and the \$25.25. So I'd
12 have to look at what that five dollar, six dollar
13 premium to market -- unless you want to know what the
14 proceeds are. I think I have a list of the proceeds,
15 but I don't have a list of -- as a result of the
16 merger. Do you understand the difference? I'm just
17 trying to draw --

18 Q. (BY MR. POZEFSKY) I believe so.

19 COM. MUNDELL: I used the word
20 compensation, but Mr. Meek had criticized that term.
21 So we can certainly be more specific on any monetary
22 benefit, whatever word we want to use. But I was
23 using sort of generically.

24 THE WITNESS: Right. Well, I'm answering
25 the question based on their sale of their stock and

1 their options.

2 Q. (BY MR. POZEFSKY) How about both? Tell
3 me both.

4 A. The distinction I'm trying to get -- and
5 I'm not trying to be obstreperous. Do you want the
6 value, the total proceeds from their stock? And then
7 I'll address Commissioner Mundell's issue of
8 compensation. The total proceeds of their stock or
9 the difference in the value of their stock before the
10 merger and after the merger? That's what I'm trying
11 to get to.

12 Q. We understand the distinction. We want to
13 know both.

14 A. I don't have the latter. It was given in
15 a data request. If somebody would just provide me --
16 if you'd permit my attorney to provide me the
17 information --

18 Q. Absolutely.

19 A. I don't have it.

20 Q. Take your time. Absolutely.

21 MR. HEYMAN: Could we have a little
22 break? Because I'm going to have to pull out a data
23 request, actually, to get it.

24 ALJ RODDA: Okay.

25 (A recess ensued.)

1 THE WITNESS: Commissioner, I guess if I
2 can respond to your line --

3 MR. HEYMAN: No, you can't.

4 ALJ RODDA: Ray wants you not to.

5 MR. HEYMAN: You could, but please don't.

6 Your Honor, could I ask for a favor? The
7 information as it is being asked is not contained in
8 one place. We have a chart that has some information
9 that we can give to Mr. Pignatelli and point out to
10 him how we come up with the answers. Is it okay
11 during the break if we now come up and talk to him?

12 ALJ RODDA: Yes.

13 MR. HEYMAN: If the question was asked in
14 shares, we could have given it to him out of the
15 proxy.

16 (A recess ensued.)

17 ALJ RODDA: We are back on.

18 MR. HEYMAN: Thank you, Your Honor.

19 I think Mr. Pignatelli was asked a
20 question about what each of the management
21 participants was going to be receiving as a result of
22 the merger. The proceeds from them that -- from that.

23 Q. (BY MR. POZEFSKY) Go ahead.

24 A. I guess I can't answer the other question.
25 That's the differential between the 19 and the 25.25.

1 I just have to give you what, the total amount that
2 each is going to receive from the sale of their own
3 stock, their owned stock and the, in the money portion
4 of their options.

5 Q. Sure.

6 A. Do you want each officer?

7 Q. Please.

8 A. Michael DeConcini, \$1,946,499. Can I
9 round these off?

10 Q. Please.

11 A. Okay. Tom Delawder, \$1 million; Steve
12 Glaser, \$2.5 million; Tom Hansen, \$1.3 million; Karen
13 Kissinger, \$1.1 million; Kevin Larson, \$1.1 million;
14 Steve Lynn, \$300,000; Dennis Nelson, \$2.5 million;
15 Vince Nitido, \$1.8 million; myself, \$9.9 million; Jim
16 Pyers, \$1.2 million. The total is \$24.5 million.

17 That is on the sale of their owned stock,
18 no matter how they acquired it, and in my case
19 represents considerable monies that I have been
20 investing in the company for ten years buying stock,
21 as well as the options. None of that comes from a
22 customer. That is all the transaction, selling
23 somebody's asset to another party.

24 Q. And that \$9.9 million that represents your
25 share, Mr. Pignatelli, that equates to approximately

1 1.1 percent of the ownership in the total company
2 currently.

3 A. It's between one and two percent. These
4 are pre-tax numbers, also.

5 Q. Okay. I would like to move on --

6 A. We have to pay tax on this.

7 Q. I'd like to move on.

8 Mr. Meek had asked you some questions
9 about the rate case filing. Actually, it's a rate
10 review filing as I understand it. And my
11 understanding is you said in your rebuttal testimony
12 that it's premature to provide information regarding
13 that filing at this time.

14 Is that correct?

15 A. The filing's been made. You can get it at
16 any time you want. I don't think it's appropriate to
17 discuss in this particular procedure because it has no
18 relevance to this procedure.

19 Q. Don't you think it's important for --
20 don't you think it's important for the Commission to
21 know whether TEP is over or under earning part of the
22 time it makes a decision on this merger?

23 A. We file with the Commission every year the
24 number, all of our financials. They can look very
25 easily at it. And I go back and tell you that we're

1 not over earning.

2 Q. If it turns out that you were,
3 hypothetically, and you were subject, TEP was subject
4 to a rate decrease, that could be the basis for a
5 revocation or rejection of the agreement. Is that
6 true?

7 A. No. Not if it's done after the thing,
8 this transaction has been approved.

9 Q. What if it's done before?

10 A. It could be a material change if it caused
11 a rate decrease. Or a revenue decrease, I should say.

12 Q. Now, I'd like to ask you a question.
13 Again, if I may, it was in response to a portion of
14 Commissioner Mundell's June 10th, 2004, letter. And
15 we provided a response.

16 And, again, this is confidential and it
17 has to do with the November 4, 2003, Strategic
18 Transition Advisory Committee notes. I don't know if
19 that's confidential or not.

20 MR. HEYMAN: Your Honor, that was
21 provided pursuant to confidentiality. We would be
22 willing to waive that confidentiality if what I
23 understand is that Mr. Pozefsky is going to be reading
24 in a portion of Mr. Pignatelli's comment to that
25 committee.

1 MR. POZEFSKY: Yes.

2 MR. HEYMAN: We would also be waiving the
3 full context of that quote. And I would like to be
4 able to give Mr. Pignatelli a copy of the response
5 that RUCO made so he can look at it.

6 ALJ RODDA: Okay.

7 MR. HEYMAN: We are grabbing the
8 documents now.

9 Your Honor, if I could, I would just like
10 to explain to Mr. Pignatelli what I'm giving to him
11 off the record.

12 ALJ RODDA: Okay.

13 MR. HEYMAN: Are you going to be asking
14 him about the response?

15 MR. POZEFSKY: Yes. I will probably read
16 most of it into the record.

17 Q. (BY MR. POZEFSKY) Now, Mr. Pignatelli,
18 have you had an opportunity to look at that question
19 and answer?

20 A. You want me to look at RUCO's answer?

21 Q. Please. Just for a second.

22 A. Okay.

23 Q. All right.

24 Now, if you look at that, the question is:
25 Please provide an analysis that discusses whether TEP

1 is earning more than its authorized rate of return.

2 Please identify the data used to support your
3 conclusion.

4 This was a question asked to us -- excuse
5 me. This was a question asked by Commissioner
6 Mundell.

7 A. Uh-huh.

8 Q. And our response was that our analysis of
9 the earnings indicates that it earned more than it
10 was -- its authorized rate of return in 2000, 2001,
11 2002 and 2003. Correct?

12 A. That's what your analysis --

13 Q. That's what our response was.

14 A. Yes. That's your response.

15 Q. Now, you just testified that TEP is not
16 over earning. Is that correct?

17 A. That's correct.

18 Q. Do you know that as a fact?

19 A. Yes.

20 Q. Okay. So your analysts, the people who
21 work on that sort of stuff, have brought those figures
22 up to the current time and have determined for sure
23 that TEP is not over earning.

24 A. Yes.

25 Q. One of the reasons why RUCO had made that

1 determination, okay, come to that conclusion, and just
2 one of the reasons, is stated in the response, and it
3 says:

4 Further, while the merger agreement was
5 still being developed, Mr. Pignatelli indicated to the
6 UniSource Strategic Transaction Advisory Committee on
7 November 4, 2003, that if the merger were delayed too
8 long it would, quote, increase the chance for a rate
9 decrease which is one of the proposed conditions in
10 which the investors can terminate the merger if the
11 ACC demands a rate decrease.

12 You see that, correct?

13 A. I see what you've just read, yes.

14 Q. First of all, do you recall making that
15 statement?

16 A. Yes, I do. And the background of that was
17 that I felt if you combined items like a general rate
18 case and a merger, that there's more chance for
19 mischief and people trying to negotiate a little bit
20 for nothing, somebody asking for more DSM money,
21 somebody asking for this, somebody asking for that,
22 and decisions not being made on the merits of the
23 costs associated with those because of the importance
24 to the company and to the community of the larger
25 issue, that being the merger. And I see it happening

1 in spades.

2 MR. POZEFSKY: If I can just have one
3 second, Your Honor.

4 ALJ RODDA: Sure.

5 Q. (BY MR. POZEFSKY) So, if, after -- if the
6 merger were to go through and after that, after the
7 merger the review case came aboard and in fact it was
8 determined that TEP was over earning and there was a
9 rate decrease, wouldn't that make it more difficult
10 for TEP to maintain a level of income that would be
11 appropriate to generate the necessary revenues?

12 A. You need to complete --

13 Q. To finance the Saguaro debt?

14 A. Certainly, if our revenues go down, income
15 would probably go down and the amount of dividends
16 would go down.

17 Q. And don't you think that the fact that it
18 could make it less -- more risky for TEP at that point
19 because it would be unable or maybe -- yeah, be unable
20 to generate those revenues or that income necessary to
21 pay back that debt, don't you think the Commission
22 should know that beforehand?

23 A. No.

24 Q. You think --

25 A. That's the risk. That's the risk of

1 current investors, that's the risk that these new
2 investors are taking. These investors have committed
3 that the money necessary to run a safe, reliable
4 service, keep management in place, keep local
5 operations is there. They are committing to \$1.5
6 billion that I believe, with my experience in the
7 industry, is necessary to run the company. If they
8 cannot cover their debt and their debt service, that
9 is their problem, not TEP's.

10 Q. Mr. Pignatelli, but you have an equal
11 interest for the ratepayers, and so does your company.
12 Why should they be subject to the risk?

13 A. What risk?

14 Q. The risk of rates going down if in fact
15 the company is over earning.

16 A. The company is not over earning. And
17 this --

18 Q. So we are supposed to --

19 A. This one-page analysis that you provided,
20 that you did, is either extremely naive or
21 duplicitous. I'm telling you flat out, you used GAP
22 financials. You didn't use FERC accounting and rate
23 making. You did not do any jurisdictional rate base.
24 You did not make known and measurable, test your
25 adjustments. You did not adjust for hypothetical cap

1 structures. You did not include working capital. You
2 did it on a pre-tax return basis, not an after-tax.
3 And then you say that you think you proved up a rate
4 decrease. That is naive.

5 Q. So the Commission --

6 A. I have seen the numbers. I know what it
7 costs to run a company. Gas is going up. We're
8 absorbing that. Everything is going up since we had
9 our last rate case. We are absorbing that.

10 Q. Why can't the Commission see the numbers?

11 A. We've given the Commission the numbers.
12 We gave a stack this big. They have the numbers. But
13 it's inappropriate to put it into this proceeding.

14 Q. So, basically, at this point we should
15 rely -- or the Commission should rely on your
16 statement that the company is not over earning. Is
17 that correct?

18 A. I'm not taking anything away from the
19 Commission's power. They can review those numbers any
20 time they want. That rate check has been filed and
21 will be adjudicated. It's not necessary to bring into
22 these proceedings. It only prolongs the proceedings,
23 creates opportunity for mischief, and would cause the
24 collapse, in my opinion, of this transaction.

25 Q. So it's your position that that

1 information is irrelevant to this proceeding.

2 A. That's correct.

3 Q. Let's move on. I'd like to go to page 26
4 of your direct testimony.

5 Mr. Pignatelli, on line 12 -- and I'm
6 going to go through a series of these statements that
7 come out of your testimony that follows from here.
8 So -- I think you'll agree with them, but I'll just go
9 through them anyway.

10 You mention that TEP has reduced customer
11 rates by 3.1 percent at a time when related
12 commodities were increasing, and that TEP also
13 negotiated a rate freeze in 1999 which, together with
14 TEP's commitment to operate more efficiently and
15 provide rate stability -- to show TEP's commitment to
16 operate more efficiently and provide rate stability.

17 Is that correct?

18 A. That's correct. It's in my testimony.

19 Q. You talk about a number of programs that
20 TEP has initiated in your testimony. And from what
21 I've heard, it sounds like there's a lot more, but I
22 will just go through the ones I've seen in your
23 testimony, like the Greenwatts program which allows
24 customers the option of paying a monthly green tariff
25 to subscribe to a block of 20 kilowatt hours of

1 electricity for two dollars.

2 That's one program, correct?

3 A. Correct.

4 Q. And that TEP has pledged the proceeds from
5 that program to maintain and operate solar generating
6 facilities in Arizona. Correct?

7 A. Correct.

8 Q. And TEP has also instituted a guaranteed
9 home program?

10 A. Correct.

11 Q. In that program, TEP inspects homes during
12 construction to ensure specific energy-efficiency
13 standards are met?

14 A. That's correct.

15 Q. And we heard some testimony today in the
16 public comment -- let's see if I can find it.

17 I believe a Mr. Lovitt talked about a
18 holiday auction spree for youth clubs. Is that
19 correct?

20 A. Yes. And I'm very proud of that.

21 Q. And Mr. White talked about the
22 contributions that TEP has made to Red Cross. Is that
23 correct?

24 A. That's correct.

25 (ALJ Rodda leaves the proceedings.)

1 Q. (BY MR. POZEFSKY) And the Tucson Urban
2 League, I believe Mr. Clarke talked about.

3 So it's fair to say that TEP has
4 contributed substantially to both profit and
5 non-profit organizations. Isn't that correct?

6 A. It's really UniSource. It's shareholder
7 money. But, yes.

8 Q. And as a result of this merger, those
9 contributions to both the -- perhaps I should wait
10 until the hearing officer comes back.

11 A. It's your choice.

12 MR. POZEFSKY: Give me one second,
13 please.

14 (ALJ Rodda enters the proceedings.)

15 Q. (BY MR. POZEFSKY) Let me continue on.

16 TEP would consider itself a good corporate
17 citizen and very active in this community, correct?

18 A. Yes, sir.

19 Q. And is very diligent in making
20 contributions in the local community. Correct?

21 A. Not only making contributions, but its
22 employees committing their own time to these
23 charities.

24 Q. And these commitments would continue
25 post-merger, assuming the merger is approved, correct?

1 A. That's correct.

2 Q. And these contributions would also
3 approve -- would also continue if the merger weren't
4 approved. Is that correct?

5 A. I can't guarantee that.

6 Q. What would happen? What would change?

7 A. The financial ability of this company.

8 Q. Are you expecting a change in the
9 financial ability of this company?

10 A. I don't know if you were listening to my
11 whole preamble. This company works in very thin,
12 narrow financial markets. There's a lot of money
13 required to continue to supply safe and reliable
14 service to the customer.

15 The first thing that I would have to
16 cut -- I would not cut reliability of service. The
17 first thing I would have to start looking at is
18 contributions and how we maintain our corporate
19 presence. I am committed to the community, but I also
20 have to provide for my shareholders. So I cannot
21 guarantee in the future \$1.5 billion. I can't
22 guarantee local offices. I can't guarantee continuity
23 of management. I can't guarantee community support to
24 the levels that I have. This merger gives me the
25 opportunity to guarantee all of that.

1 Q. I think in your preamble I heard you say
2 that this merger -- well, that this community has a
3 first-class utility. Correct?

4 A. That's what I want.

5 Q. It's what you want.

6 A. With the merger, this becomes a
7 first-class utility.

8 Q. Do you consider it a first-class utility
9 at this point?

10 A. It's got first-class people but it doesn't
11 have the financial wherewithal to be a first-class
12 utility.

13 Q. And you believe that could happen because
14 of this -- will happen as a result of this merger.
15 Correct?

16 A. I was going to use will.

17 Q. Okay.

18 A. Yes.

19 Q. Well, unfortunately for me, I think I'm
20 coming to the end, Mr. Pignatelli. But let me ask you
21 a few more questions if I may.

22 Your attorney talked about a trust and
23 verified policy. Is that something that you endorse
24 or is that what you're asking the Commission to do on
25 this merger, a trust and verified policy?

1 A. I thought it was a nice turn of words.

2 Q. I think Mr. Reagan used it.

3 A. I think what my attorney was saying is
4 that we have offered conditions that will assure safe,
5 reliable service to our customers and we have offered
6 conditions that will assure appropriate separation of
7 entities. We have offered conditions which would
8 essentially and forever protect TEP, UES Electric and
9 Gas from debts of other parties. We have offered
10 conditions to provide all of the information, the
11 access to books and records that the Commission
12 currently has and more.

13 And I guess my attorney compresses those
14 40 conditions to these conditions should show you that
15 we trust you, Commission; you trust us; you have all
16 the information necessary to do your job, just like
17 you've done it in the past, and you have 40 more
18 controls over us. If that's trust and verified, then
19 I'll say it's trust and verified.

20 Q. So your answer is yes.

21 A. That's what I said.

22 Q. The last area I want to talk to you about
23 is the standard that we've been talking about.
24 Because I'm not really sure I understand for sure the
25 company's position. And I'm not going to ask you to

1 draw upon a legal conclusion. And if I do, I'm sure
2 I'll be told about it.

3 But I will ask you, since you've testified
4 to it, I believe in your rebuttal testimony, you say
5 that Ms. Diaz Cortez, in her testimony, ignores the
6 standard that you're talking about up on the board,
7 the no-harm rule.

8 Is that correct?

9 A. Correct. I believe that the appropriate
10 standard is as put forth in the Commission's, what I
11 call affiliate transaction rules. You have to
12 remember that the Commission's jurisdiction -- these
13 are not jurisdiction -- UniSource is not a
14 jurisdictional company. The Commission put in place,
15 it's my understanding -- and if you want, we can
16 proffer the person who drafted the rules so that you
17 can get the intent behind the rules.

18 But it's my understanding the Commission
19 put these rules in place, and it was a no-harm
20 standard. And the rules were approved under the
21 Commission's discretion in a court decision because
22 the Commission has broad authority over utility
23 matters. But the test is the no harm.

24 Be that as it may, I have proffered
25 testimony that supports -- we go beyond, much beyond

1 the threshold no harm and we have shown benefits which
2 meet the interest, public interest standard. Because
3 we have shown the benefits of all of the appropriate
4 constituents, constituencies: Customer, community,
5 employee, owner, regulator, and state. We have shown
6 benefits in all of those areas and we believe that we
7 more than carry the no-harm, but we carry the public
8 interest because of those tests, because of those
9 benefits.

10 Q. Okay. So your rebuttal testimony that I
11 quote -- I didn't quote, that I paraphrased that from
12 was in response to Ms. Diaz Cortez's testimony in
13 which she talks about the public interest. My
14 question to you -- and I think you've answered it but
15 maybe you can answer it again -- is do you believe
16 that the Commission should consider whether or not
17 this is in the public interest? That would be a fair
18 thing for the Commission to consider, is that correct?

19 A. No. I think they should follow the rule,
20 the no-harm rule. But we went beyond that. Not
21 because of your witness' concern, because of concerns
22 that I had heard by some of the Commissioners that
23 they wanted to look at the public interest. And I'm
24 more than happy to stand up to the public interest.

25 Q. I know you went beyond it, but do you

1 think the Commission should go beyond the rule?

2 A. No. I think the Commission actually
3 should go by its no-harm standard.

4 MR. POZEFSKY: Thank you.

5 Your Honor, I have nothing further. Thank
6 you.

7 ALJ RODDA: Thank you, Mr. Pozefsky.

8 Mr. Magruder, the other day you indicated
9 that you had, you thought, maybe 45 minutes of cross.
10 Based on what you've heard gone before you, do you
11 still have that?

12 MR. MAGRUDER: Yes, Your Honor. It might
13 be just a little longer.

14 ALJ RODDA: Then what I'm going to do is
15 I am going to call Mr. White in Mohave County who has
16 been listening in because he has a limited number of
17 questions. What I think we will do then is finish up
18 today with Mr. White and start in the morning with
19 Mr. Magruder and then Staff. Anyone have any
20 heartburn over that? Okay.

21 Mr. White, can you hear me?

22 MR. WHITE: Yes, ma'am, I can. Can the
23 witness hear me?

24 THE WITNESS: Yes, I can, but I'd
25 appreciate your indulgence because I'm hearing

1 impaired. So if you could make your enunciation as
2 positive as possible, I'd appreciate that.

3 MR. WHITE: Your Honor, I can barely hear
4 Mr. Pignatelli.

5 THE WITNESS: Can you now?

6 MR. WHITE: A little bit better, sir.

7 THE WITNESS: How about now?

8 MR. WHITE: No. It's not as clear as it
9 could be, but I was tricked by this streaming audio.
10 The streaming audio is clear as a bell but it's got a
11 horrible delay that makes it impossible. It's sort of
12 like talking between here and Mars.

13 ALJ RODDA: I'm moving the phone closer
14 to the witness so maybe that will help your ability to
15 hear him.

16 MR. WHITE: Thank you, Your Honor.

17 THE WITNESS: Can you hear me now?

18 MR. WHITE: Yes, sir. I can hear you
19 much better now. And if I go slow and you kind of go
20 slow with me, I think that it will move very quickly.

21

22 CROSS-EXAMINATION

23

24 Q. (BY MR. WHITE) Mr. Pignatelli, I'm
25 referring to your direct testimony filed on February

1 12th, 2004. I believe that Mr. Heyman has already
2 asked for and this has been admitted into evidence.
3 I'm referring specifically to page one of that
4 testimony, beginning at line 22, and then it goes to
5 page two.

6 And in response to a question in which you
7 were asked, Mr. Pignatelli, please summarize the
8 benefits of the merger for us, your answer was:

9 "Certainly. In summary, the benefits of
10 the merger include, but are not limited to, a cash
11 infusion of up to \$263 million in TEP. TEP will
12 receive an equity contribution of up to \$168 million
13 and repayment of the \$95 million intercompany note
14 from UniSource Energy to TEP. TEP will use this cash
15 infusion to retire debt and thereby approve its
16 debt/equity ratio from approximately 75/25, beyond the
17 hypothetical 62.5/37.5 authorized by the Commission in
18 our last rate case, to an actual ratio of 60/40,
19 accelerating achievement of this diagnosed regulatory
20 and financial goal by at least five years."

21 My first question with regard to that part
22 of your testimony, sir, is what rate case were you
23 referencing in that statement?

24 A. The rate case that's referred to there is
25 the 1994 proceeding, I believe. I'll get you the cite

1 number. I don't have it with me but I'll get the cite
2 number for you.

3 Q. In other words, is it a TEP rate case?

4 A. Yes.

5 Q. Okay. And it's a 1994 TEP rate case?

6 A. I think that's when the original, when the
7 last one was.

8 Q. Okay. Thank you. I just didn't know what
9 that referred to.

10 My second series of questions goes more to
11 the current transaction. First of all, sir, I think
12 you testified that you're familiar with the financial
13 conditions of TEP, at least the current financial
14 conditions, and I would limit those years to say 2002
15 to the present.

16 Would that be a correct statement, sir?

17 A. That's correct.

18 Q. And are you also familiar with the ACC's
19 regulatory restriction on dividends payable to TEP
20 currently?

21 A. Yes, I am.

22 Q. Okay. What is TEP's current annual net
23 income after capital expenditures?

24 A. Capital expenditures don't impact net
25 income except to depreciation in the future. So I'll

1 tell you that TEP's current net income after tax runs
2 around \$50 million.

3 Q. Fifty million, did you say, sir?

4 A. Yes.

5 Q. Okay. That's your after-tax?

6 A. Income.

7 Q. Okay. And currently, then, under TEP's
8 75/25 debt equity ratio, what percentage of that
9 income can TEP provide to UniSource in dividends?

10 A. We generally provide about 75 percent of
11 that.

12 Q. Okay. So, by retiring the debt with the
13 \$263 million infusion and bringing TEP's debt equity
14 ratio up to 60/40, what percentage of that income can
15 you -- can TEP provide to UniSource in dividends?

16 A. A hundred percent.

17 Q. Okey-doke.

18 Has UniSource scheduled a debt of any of
19 its other companies in its family of companies? And
20 by that I mean the old Citizens companies that are now
21 UES. Has UniSource scheduled a debt of any of those
22 other companies for retirement as part of the Saguaro
23 transaction?

24 A. No. We have not scheduled any of those.
25 We capitalized those initially at 40 percent equity

1 and about 60 percent debt, and the bonds on those are
2 privately held by insurance companies and have between
3 a five-year and ten-year maturity. But we have not
4 scheduled any of those because the equity infusion
5 goes to TEP to bring its equity to the same percentage
6 as what we initially capitalized the old Citizens
7 companies, as you referred to them.

8 Q. Okay. Thank you, sir.

9 And what is UniSource's -- and when I'm
10 talking about UniSource, I mean UniSource the company
11 you run. What is its debt now?

12 A. The total debt?

13 Q. Yes. Does it have a heavy debt load?

14 A. It depends on -- yes, it does. And it
15 depends on how you treat the leases. It --

16 Q. Capital leases, you mean, sir?

17 A. The leases. The leases are, if they're
18 capital, then you impute debt on the leases. If they
19 are operating leases, you don't utilize it.

20 Q. Okay. Then if you treated them as
21 operated leases, what would your debt be? UniSource's
22 debt, that is, sir.

23 A. Total debt, we have -- I'm looking for my
24 CFO.

25 MR. HEYMAN: Your Honor, I assume it's

1 okay if he consults with the CFO.

2 ALJ RODDA: Yes.

3 MR. HEYMAN: Thank you.

4 THE WITNESS: Including the debt on the
5 old Citizens properties and TEP's debt, \$1.4 billion.

6 Q. (BY MR. WHITE) That's UniSource's, that
7 would be at the UniSource level, at your company's
8 level.

9 A. That's correct.

10 Q. Okay. And how much increase in that debt
11 will UniSource have after the transaction? Let me
12 explain why I'm asking.

13 Earlier in the testimony, Mr. Pozefsky had
14 asked, he had asked questions about, I think there was
15 an issuance of some \$660 million in securities and
16 \$527 million in equity and cash. Okay?

17 A. Yes.

18 Q. To bring it up to \$1.3 billion, I think.
19 And the reason I'm asking the question of how much
20 increase in debt will UniSource have --

21 A. Right. The total debt, when you include
22 debt taken on by the investors, will be about, a
23 little less than \$400 million higher than the current
24 debt.

25 Q. Okay.

1 A. But I look --

2 Q. And so --

3 A. Could I please finish?

4 Q. I'm sorry, sir. I couldn't hear. Go
5 ahead.

6 A. But I look at that as we have transferred
7 debt that is on the jurisdictional utilities in the
8 amount of approximately \$260 million. We have
9 transferred the obligation of that to the
10 non-jurisdictional entities and thereby reduced the
11 risk to the consumer and to the jurisdictional
12 companies.

13 Q. Okay. So, so that I can understand the
14 numbers, because I just have chicken scratchings here,
15 I have 660 minus 260 equals four million, and that --
16 is that the four million, about four million you're
17 talking about, sir?

18 A. If you add a couple zeros, yes.

19 Q. I'm sorry. Yes, 400 million. It was
20 really chicken scratchings.

21 Earlier, you said that you're familiar
22 with the financial conditions of TEP. Is TEP
23 currently, already from its revenues meeting its debt
24 and retiring its debt satisfactorily?

25 A. Yes, it is.

1 Q. Then why does TEP now need to have that
2 \$263 million infused in order to retire debt if it's
3 satisfactorily retiring its own debt based on its own
4 revenues?

5 A. Because I would like to see TEP returned
6 to financial health about seven years, somewhere
7 between five and seven years before it would normally
8 get there. I am 61 now, and I have committed to
9 myself to return TEP to financial health before I
10 retire.

11 MR. WHITE: Well, thank you very much,
12 sir.

13 Those are all the questions I have, Your
14 Honor?

15 ALJ RODDA: Okay. Thank you, Mr. White.

16 MR. WHITE: Thank you, ma'am.

17 ALJ RODDA: All right. Then we are going
18 to adjourn for the day and meet here at 9:00 a.m.
19 tomorrow morning. We will start with Mr. Magruder.
20 Mr. Robertson is here, and any other Intervenors, and
21 then we will get to Staff. And the panel is up
22 tomorrow after that.

23 (Proceedings recessed at 5:06 p.m.)

24

25

1 INDEX

2 ITEM PAGE

3 Public Comment 10

4

5 INDEX TO EXAMINATIONS

6 WITNESS PAGE

7

JAMES S. PIGNATELLI

8

Direct Examination by Mr. Heyman 101

9 Cross-Examination by Mr. Meek 122

Cross-Examination by Mr. Pozefsky 136

10 Cross-Examination by Mr. White 191

11

12 INDEX TO EXHIBITS

13 NO. DESCRIPTION IDENTIFIED ADMITTED

14 A-1 Notice of filing and direct 102 104
testimony of James Pignatelli

15 A-2 Rebuttal testimony of 102 104
16 James Pignatelli

17 A-3 Notice of filing and summaries 103 104
18 of testimony of James Pignatelli

19 AVIA-1 Letter dated June 15, 2004 134 158
to ACC from Walter W. Meek

20 AVIA-2 Direct testimony of -- --
21 Walter W. Meek

22

23

24

25

1 STATE OF ARIZONA)
2) ss.
3 COUNTY OF MARICOPA)
4

5 WE, DAWNA J. BOSWELL and ANNETTE
6 SATTERLEE, Certified Court Reporters Nos. 50326 an
7 50179 for the State of Arizona, do hereby certify that
8 the foregoing printed pages constitute a full, true
9 and accurate transcript of the proceedings had in the
10 foregoing matter, all done to the best of our skill
11 and ability.

12 WITNESS my hand this 22nd day of
13 June 2004.

14 Dawna J. Boswell

15 DAWNA J. BOSWELL, RPR
16 Certified Court Reporter
17 Certificate No. 50326

18 WITNESS my hand this 22nd day of
19 June 2004.

20 Annette Satterlee

21 ANNETTE SATTERLEE, RPR
22 Certified Court Reporter
23 Certificate No. 50179
24
25